Empire of Pain[1] (and some other stories)

For professional economists, the nature of business is a building block of economies, capitalism and one of the first lessons in microeconomics is the construction of cost and demand curves and how competition will generate maximum benefit for minimum cost. Clearly competition is often imperfect and oligopoly and monopoly need to be understood and where necessary curbed. But the underlying model remain a core tenet of economics.

Recently a swathe of books have appeared which suggest that such desirable outcomes as the standard model suggests are more honoured in the breach than the observance. Empire of Pain is about the Sackler dynasty – owners of Purdue which manufactured and sold Oxycontin as the basis of the opioid epidemic – but also notable philanthropists. Other recent examples include the story of Theranos[2], of Wirecard[3] and of Greensill Capital[4]. All of these books are exciting reads and scary for their implications. I am interested in whether there is a thread here which needs to be understood by economists and incorporated into our thinking.

The story with the most wide-ranging consequences must be that of the Sacklers. It's a tale in three parts. The first is about the invention of a method of drug marketing direct to doctors which was originally for the benefit of Valium, Librium and the Roche company. That was the eldest brother. He bought a pharmaceutical company for the two younger brothers, who recognised there was only limited growth in the market for the antiseptics in which they were engaged. They turned to painkillers, arguing that pain was an unrecognised and destructive condition. They bought a company which had patented a coating which dissolved slowly and enabled the painkiller to release over time and harnessed the power of advertising (eldest brother) to suggest that this meant that addiction could not happen. Finally, once one patent ran out, they created a stronger drug without properly describing how it had the strength of heroin.

All of these companies were privately held and not subject to the kind of oversight a public company has. Much of the book tells of the gyrations the family went through both to hide their connection with the drug business and to minimise the impact that it was having in creating addicts, enabling pill pushers or encouraging methods of removing the slow release coating.

Theranos too was privately held and so too was Greensill for much of its life. Both Wirecard and Greensill had 'normal' front businesses which employed most of their staff. Wirecard was a platform for credit card payments, and Greensill for supply chain finance – enabling suppliers to be paid quickly by making a loan to the purchaser which could be paid back later. Neither of these businesses was particularly profitable and indeed could be loss making. They both made their real money in much more shady ways. Wirecard had a system of third party relationships which have turned out to be essentially a Ponzi scheme using the next set of revenues to pay off the previous set. Greensill used funds ostensibly only available for loans backed by actual invoices to lend on unsecured assets or assets backed by prospective rather than actual invoices. A front of respectability is a good start.

So too is the ability to persuade the great and good of your bona fides. This includes audit firms as well as politicians and philanthropic institutions in need of funds. The Sackler name has been blazoned across leading museums and universities, although it is slowly being erased as campaigners

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[1] Patrick Radden Keefe, Empire of Pain, Pan Macmillan, 2021
[2] John Carreyrou, Bad Blood, Pan Macmillan, 2018
[3] Dan McCrum, Money Men, Penguin, 2022
[4] Duncan Mavin, Pyramid of Lies, Pan Macmillan, 2022

who have lost loved ones to opioid abuse protest that the naming rights were bought with addictive drug selling. Greensill's name was less noisy, but Lex Greensill supported the Monteverdi choir and other cultural endeavours. Notoriously, he recruited David Cameron to help open doors, subsequent to Cameron stepping down as Prime Minister. Theranos had Henry Kissinger and George Shultz on the board. Shultz's grandson, Tyler, became one of the important whistleblowers on Theranos, against much pressure.

Finally a major thread that connects these stories is the use of legal pressure and the more aggressive the better. Threats of litigation, the use of intimidation, and layers of shell companies seem to be created to obfuscate and enable money to be used for purposes, particularly lifestyle purposes, beyond those for which the business formally existed.

Of course, these scandals could be systemic to our system, or could be the result of bad apples which can pop up anywhere. Exciting stories of bad behaviour are bound to attract journalists. The question becomes how we might minimise the opportunities for bad apples, or whether the regulatory system across all business works well enough. All the examples cited here are recently exposed but some go back, in the case of the Sacklers, for years. All gave off warning signs for which journalists, whistleblowers and activists tried and often failed to get traction.

What's going on?

One possible argument is that small is beautiful. Small firms have no choice but to compete and on that basis the standard model could prevail. While possibly true, it is not the experience of the last couple of hundred years. Economies of scale and waves of globalisation both conspire to create large firms. While the standard model of the firm is one building block of economics, the other is the benefits of trade and the expansion of trade has tended to produce larger and larger businesses. Add in the network effect and global firms such as Facebook, Apple, Amazon and Google emerge. And once large enough, the opportunity to recruit heavyweight lawyers, financiers and so on to protect your position becomes easier. We need to live with large firms.

Once large enough then oversight does become crucial. The Sacklers never had a quoted company and could hide their relationships behind private structures. This made scrutiny much more difficult. By the time that Purdue was declared bankrupt, there was nothing left in the business to distribute.

On the other hand, it is foolish to expect some magic regulatory bullet. Every time there is a failure of oversight, a new set of rules is promulgated. This certainly creates new industries for consultants and advisers. It's not clear how far it actually incentivises good behaviour rather than a willingness to tick the box (or appear to). It will always be the case that those inside the business know more about it than any regulator. Indeed on consequence of tighter rules for quoted companies has been a surge of companies going private.

The answer has to lie in encouraging good behaviour and principles. That includes the behaviours of lawyers, advisers, and accountants. It's rather depressing, and it's not a quick fix. As with so many apothegms there is no evidence that Thomas Jefferson ever said that the price of liberty is eternal vigilance. Nevertheless that is the duty laid on us all.

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