Moral Dimensions of Financial Crisis
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What Happened? A Subprime Primer
(http://wwwsom.yale.edu/faculty/Sunder/Subprime%20explainedOct2008SOMR.pps, the origins of this presentation are not known to me. If you happen to know the name of the author, please let me know for appropriate attribution).

Probable Causes of the Financial Crisis
1. Attempts by government to expand home ownership beyond those who qualified for traditional mortgages to those who may not have the resources for owning homes—the rise of subprime mortgages.

2. Residential homes increasingly came to be seen as commercial assets of value to be bought and sold as opposed to a permanent place of residence to be used and passed on to future generations.

3. Structure of mortgage markets: (Almost) everyone—the sellers, brokers, bankers, assessors, insurers, builders, and even buyers—benefited from rising home prices so there was little downward pressure on home prices to keep the market in balance. This was combined with the widespread belief, encouraged by the real estate industry, that the home prices “always go up” encouraging entry of non-professional speculators into the real estate market.

4. Securitization of mortgages in increasingly complex instruments that were not understood by those who were persuaded to buy them.

5. Absence of incentives for due diligence on part of the mortgage initiators because they could sell the mortgages to others without recourse (switch from originate-hold-collect to originate-sell-no responsibility for collection mode for mortgages).

6. Conflict of interest on part of the derivatives ratings agencies (Standard & Poor’s, Moody’s and Fitch were paid by those who wanted them to rate the derivatives at high grades).

7. Ability of Fannie Mae and Freddie Mac to lobby Congress at massive scale to frustrate the attempts to properly regulate these giant public-private hybrid entities.

8. Failure of the Federal Reserve Bank and the U.S. Treasury to perform their regulatory duties in (1) preventing a real estate bubble through control of money supply, (2) preventing excessive leveraging in investment banking, (3) ensuring transparency of derivative transactions, possibly through a central registry and clearinghouse, and (4) formation of financial institutions which were “too big to fail.” Incidentally, since these
regulators continue to encourage, even facilitate, formation of even larger financial entities, this regulatory failure has become intensified instead of being mitigated since recognition of the financial crisis.

9. Willingness of the Securities and Exchange Commission and the accounting rule writers to allow large liabilities in the financial sector to remain hidden from view under opaque labels such as SIV (Structured Investment Vehicles).


11. Willingness of U.S. and EU to allow continuation of transactions with opaque financial regimes and tax havens (e.g., Switzerland, Caymen Islands, etc.)

Related Issues:
1. Provision of resources (food, shelter, education, healthcare, etc.) for those who have less, and need or ask for more. Who should decide and who should provide such support? Individuals or government or some other collectivity? How much?
2. Consequences of using public funds on demand for subsidies (charity with others’ money and its effect on systemic viability).
3. Consequences of subsidies for those who decide on them in a democratic polity.
4. Role of incentives/self-interest/greed in economic, social and religious systems
6. Alternatives to self-interest as organizing principle of society—altruism?
7. Efficiency and inefficiency of scale (e.g., in the banking system).
8. Balance between decentralization (freedom of individuals and groups to act) and monitoring (control to make sure that these actions do not bring harm).
9. Cartesian (top down design from omniscient knowledge) and Darwinian (bottom up emergence through complex and hard-to-understand interactions among elements of the system) approaches to development of social systems.
10. Consequences of keeping the (car?) factories open with public money.
11. Contracts: financial, economic, social, metaphysical (Russian dolls structure?)
Dear Shyam,

Thanks so much for all your work and the materials you have sent to make the discussion possible. I have forwarded the PPT file to all who have RSVP’d (and to several others who had not responded or asked for the file after sending regrets). I think you have included enough material and questions to chew on for at least a semester of discussions.

I continue to wonder if it would be useful to discuss the question of the “need” for moral language in the various loci of the problem. That is, I would like to ask the group to consider whether it is necessary to invoke moral norms (as opposed to a simple argument from the utility of contracts, transparency, and equal opportunity) at the various levels of market functions and regulation. Those decision making loci would include:

- When a broker or seller makes representations of value and risk to a potential buyer
- When a consulting agency or auditor offers professional assessments of values and risk or issues a rating of same
- When a government agency sets a policy to intentionally achieve a redistributive goal related to differing visions of social equity
- When a regulating agency evaluates the risk and potential impact of complex financial instruments, conflict of interest, and social utility of new financial instruments.

There are certainly other possible points of entry for moral language, but I wonder if the requirement for such varies based on the sort of market questions asked and based on the relationship of the various players.

I am looking now for various pithy quotes from some of the business ethics’ standard-bearers to see if I can help bring out the issues in better contrast for our rather short timeframe available for discussion. I am guessing that we will have a number of “moral partisans” in the group. And that it might help if they could be encouraged to think of the specific ways that moral language might actual add to the general goal of overall human flourishing and to consider some of the difficulties of such language. For instance, moral language usually requires some sort of metaphysical basis (no ought from is) and this raises issues for anyone functioning in a global system with radically differing views and even differing views of pluralism. Do we need to have metaphysical contracts in addition to social contracts that underlie the kinds of material and financial contracts that make markets possible?
Again, I have doubts about how far we can actually go with these questions, but the purpose of the lunch is to spark enough discussion so that participants will be encouraged to think and write and work in each of their own fields... And hopefully we can return to these discussions over time to hear exactly what may have germinated in the interim.

Yours,

Rick