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Midwest Studies in Philosophy, XLII (2018)

Responsibility in the Financial Crisis

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The global financial crisis began in 2007, and we are still feeling its effects. It involved the collapse or near-collapse of large commercial banks, hugely expensive interventions by governments to guarantee deposits and buy bank assets, a steep decline in bank lending to individuals and businesses, significant falls in consumer activity both domestic and international, and a resulting reduction in trade. Government indebtedness due to the crisis has resulted in diminished welfare states in Western Europe and a worsening of the position of the worst off in developed countries. In the United States, repossessions of properties rose very markedly after 2006, and members of both low- and middle-income groups have at times been very badly affected.

Two natural and related questions about the crisis are "What caused it?" and "Who, if anyone, is to blame?" Neither admits of a simple answer. The first is caught up with the difficulty of establishing an uncontroversial narrative of the crisis that is suitably related to data on previous, more local, financial crises.[1] The problem of a reliable narrative also affects the question of blame-

1. The literature on financial crises identifies at least four distinct types, which in practice often overlap. The criteria for identifying an event as a crisis of a particular type are disputed, as are the explanations for how each occurs. Such uncertainty also creates challenges for identifying the real effects of crises. On these points, and their relation to analysis of the recent crisis, see Stijn Claessens and Ayhan Kose, "Financial Crises: Explanations, Types, and Implications," IMF Working Paper WP/13/28, http://www.imf.org/external/pubs/cat/longres.aspx?sk=40283.0

DOI: 10.1111/misp.12081
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worthiness, which, in addition, is beset with philosophical complications. If people involved in the crisis are blameworthy, they have to have contributed in significant ways to the collapse of large commercial banks, the credit shortage, and so on. The scope for *individual* responsibility for such large-scale effects may at first appear to be slight. And although there have been journalistic attempts to identify guilty individuals, these assignments of blame are disputable.

Some people say that a bad "culture" grew up in banking in the years leading up to the crisis, and that this, more than individual action, or this *rather* than individual action, operated to create the crisis. Even if this view is wrong, and there are identifiable guilty, and therefore blameworthy, people, *should* we blame them? This question bears two senses, depending on whether blame is interpreted as an attitude or a public practice. Although there may be people who feel qualms about adopting even the *attitude* of indignation toward bankers or regulatory authorities, I will proceed as if this is unduly charitable or purist. More controversial may be a *public practice* of blaming bankers, say by imprisoning or fining some of them, or short of that, bringing them before parliamentary committees, demonstrating outside bank headquarters in the City of London or Wall Street, running press campaigns aimed at forcing resignations, or exchanging derogatory comments about individual bankers and bankers in general on social media.

Should bankers be blamed through public practices? Sometimes there can be good reasons for *not* publicly criticizing or punishing people who are responsible for wrongdoing. For example, it might make sense not to blame people who blame themselves already and who do what they can to put things right. Differently, it might make sense not to blame people who, though they were in charge when things went wrong, were as conscientious as anyone could be, but were ineffectual even so. Do any of these reasons for not blaming people apply to the banking crisis? No. Although some of the investigatory reports on the banks try to enter into patterns of financial thinking prior to 2007 in order to see whether decisions were unreasonable by standards prevailing at the time,[2] this seems to ignore the fact that standards in 2007 were themselves a conscious departure from standards that in the recent memory of bankers were taken to be demanded by prudence. Nor was the financial crisis so big and so complex that the actions of individuals dwindle into insignificance. According to me, some individuals *do* stand out as reasonable targets of opprobrium, complex as the crisis is. This is because they occupied positions

2. For example, the UK Financial Services Authority's report into the failure of the Royal Bank of Scotland accepted that the RBS management and board made poor decisions, but found that they were not sanctionable under law or the FSA rules because processes and controls were not clearly deficient, and the decisions were not outside the bounds of reasonableness, given the information available at the time. See Financial Services Authority, "The Failure of the Royal Bank of Scotland: Financial Services Authority Board Report," http://www.fsa.gov.uk/rbs. The U.S. government's Financial Crisis Inquiry Commission likewise blames institutions more often than individuals. See *Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* (subsequently abbreviated FCIC) (Washington, DC: U.S. Government Printing Office, 2011.

of leadership or authority in which they enjoyed considerable latitude to act and make far-reaching decisions. These people were not new to their positions when the crisis started, and their duties certainly extended to informing themselves about and judging the risks of activities that led to the crisis.

This is not to say that every piece of wrongdoing in the crisis can be apportioned to specific people: sometimes it may be plausible to speak of corporate failure—in the sense that there was a questionable consensus in an organization about what was permissible that no one person orchestrated or created. Again, regulatory failure is likely to be ascribed to institutions, unless there are special reasons to believe otherwise—for example, a history within the institution of general deference to some one person within it, or a management structure assigning great authority to a particular office within it. But the idea that, in general, the responsibility for the banking crisis can *only* be collective, or that it attaches itself to a noxious culture that insulates people from *personal* blame, seems to me to be wrong.

I shall outline a framework that permits responsibility in the crisis to be ascribed to individuals as well as institutions. This framework leans heavily on the idea that banks in general have distinctive public purposes, that roles in both banks and regulatory bodies are well enough defined to permit moral judgment of actions within these roles, that actions within these roles are *supposed* to be judged—by the public, designated insiders, and regulators—and that some decisions taken within these roles were highly damaging in the early 2000s. Size and connectedness also matter. Big banks whose fortunes affect a national banking system are spectacularly unsuitable sites for recklessness. A national banking system has some claim to belong to the Rawlsian basic structure of a liberal democratic jurisdiction, and "systemically important" banks affect the banking branch of the basic structure. If decisions made by ostensibly private actors in private banks can predictably unhinge the banking system, those ostensibly private decisions, private roles, and private institutions are strongly public-aspected, and carry special responsibilities that attach to individuals who lead banks. In a sense, executives of big, system-affecting banks play public roles, and not just after big banks have been bailed out by governments. Nor does personal responsibility in those roles make bankers answerable only to shareholders and regulators, since the safe-keeping of the banking system is bound up with the vital interests of a whole citizenry in developed countries.

I

The main events of the financial crisis (at least at its epicenter in the United States in 2007–2008) have been summarized in the Introduction to this volume. Complex as those events certainly were, they were not acts of God or the components of a natural disaster. Most, if not all, resulted from decisions within financial institutions and regulatory bodies, primarily in the United States. The U.S. Financial Crisis Inquiry Report makes a lengthy and well documented case for holding responsible the Federal Reserve and other

regulatory agencies in the U.S. financial sector. These agencies, the report shows, were given timely information about problems in the subprime market, including fraud and predatory lending, and were also aware of accounting problems in Fannie Mae and Freddie Mac that predated the events summarized in Table 1 of the Introduction.

The regulators either did nothing or too little. As for the private sector, many important risk-taking decisions directly related to the events in Table 1 can be traced to decisions by executives in banks, money market funds, and insurance companies. Some of these decisions seemed imprudent to dissenting senior insiders when they were made, and were even matters of dispute leading to resignation. It is not only in hindsight, then, and not only to outsiders, that these decisions seemed irrational. After discussing the case against the regulators, I shall go on to give examples of some of the decisions that arose within financial institutions. As will emerge, some of those decisions are naturally attributed to individuals within those institutions rather than the institutions themselves.

According to the U.S. Financial Crisis Inquiry,

> [regulators] had ample power in many arenas and they chose not to use it. To give just three examples: the Securities and Exchange Commission could have required more capital and halted risky practices at the big investment banks. It did not. The Federal Reserve Bank of New York and other regulators could have clamped down on Citigroup's excesses in the run-up to the crisis. They did not. Policy makers and regulators could have stopped the runaway mortgage securitization train. They did not. In case after case after case, regulators continued to rate the institutions they oversaw as safe and sound even in the face of mounting troubles, often downgrading them just before their collapse. And where regulators lacked authority, they could have sought it. Too often, they lacked the political will—in a political and ideological environment that constrained it—as well as the fortitude to critically challenge the institutions and the entire system they were entrusted to oversee. (FCIC, p. xviii)

The Federal Reserve Board in Washington comes in for particular criticism, because at least one of the Fed governors, Ed Gramlich, was very sensitive to problems in the mortgage market as early as 2000 and voiced them in public, but apparently thought he could make no headway in the Fed Board more generally. The Fed's leader—Alan Greenspan—believed deeply in the capacity of markets to regulate themselves. In 2002, bad mortgage lending practice had gotten out of control, partly because the institutions involved believed that securitization had the effect of spreading risk and also that supposedly low-risk tranches of securities really were low-risk. In fact, judgments of risk relied on credit rating agency models of risk that were very defective (FCIC, p. 28) and had been influenced by the banks themselves.

Problems with regulation went beyond failure to curtail high-risk lending. There was the fact that different financial institutions could choose between

federal and state supervision, and between recognized regulators at each jurisdictional level.[3] This created a kind of market in regulators in which the more lenient were likely to be chosen by institutions legally required to have oversight (FCIC, p. 20). Again, in the early 2000s, stringent state regulation of predatory lending and other bad lending practices was judged to interfere unlawfully with certain federal regulatory prerogatives, thereby undermining some tightening up of lending that might otherwise have taken place. In this way, the clash between state and federal governments and a competition between them to grant bank charters aggravated the failings of what was already an ineffective regulatory regime.

Within investment banks themselves, many decisions were made that seemed questionable to insiders before and during the period covered by Table 1 (see Introduction). A number of these decisions were directly relevant to the failure of Lehman, which in turn arguably marked the high point of the crisis. For example, some decisions made in 2008 within Lehman were supposed to reverse declines in its share price after the collapse of Bear Stearns. Lehman tried to reassure investment analysts who doubted that Lehman was sound, and it also put pressure on regulators to outlaw "shorting" of its shares.[4] Regulators were unreceptive to the pressure, and the reassurance offensive was also unsuccessful. At the heart of the failure of the latter was the fact that Lehman assets—many of them mortgage-backed securities—*were* overvalued, and that there was confusion even at high levels in the firm about the accounting conventions used to communicate their values. "Mark to market" measures gave an up-to-date valuation, but Lehman used figures that were only updated quarterly. This meant that the valuations were unduly optimistic.[5] The same optimism had affected declarations for investors and regulators close to the time of the failure of Bear Stearns that Lehman had a strong balance sheet, and that it was therefore *not* next in line to fail or to seek a buyer for its distressed assets.

Long before Lehman reached crisis point, its chief executive officer, Richard Fuld, and its president, Joseph Gregory, had backed heavy investment in real estate—investment ranging from direct purchases of famous New York office buildings and massive residential development projects on the Florida and California coasts, to securitized mortgages. Fuld and Gregory had backed the judgment of Lehman's real estate director, Mark Walsh, who gained a reputation for bold, high-risk deal-making. When the property market started its decline, this aggressively developed line of business made its own contribution to Lehman's failure. Although the decision to concentrate

3. Richard J. Rosen, "Switching Primary Federal Regulators: Is It Beneficial for U.S. Banks?" Economic Perspectives 29, no. 3 (2005):16–33.

4. Shorting or short-selling takes place when shares are borrowed from brokers and sold—in the hope that they can be repurchased later at a lower price, and returned to the lender at a profit to the short-seller.

5. For a vivid and detailed account of how these accounting unclarities led to a highly influential recommendation by a hedge fund manager called David Einhorn to sell Lehman shares in May 2008, see Andrew Ross Sorkin, *Too Big to Fail* (London: Penguin, 2009), 100ff.

investment in real estate is not on its face a case of wrongdoing, it was arguably imprudent and to that extent a step on the way to the precarious position reached later by Lehman.

Many other examples can be given of bad decisions in organizations that have already figured in the summary of the crisis given in the Introduction. AIG's decision to involve itself deeply in credit-default Swaps is one example. As has already been seen, this generated unsatisfiable collateral demands when Lehman was on the point of failing. Reserve Management made a bad decision to start to invest in mortgage-backed securities when it had previously invested only in U.S. government-issued securities. This was not a decision that seemed uncontroversial at the time it was made, as it was the subject of a disagreement between the father and son who ran Reserve Management.[6] The folly of these decisions was magnified by the holdings of both AIG and Reserve Management in Lehman. Further examples of imprudent commercial behavior can be found in organizations at one remove from Lehman. There were the disproportionately real estate–focused strategies of both Merrill Lynch and Citigroup, allied to their policies of borrowing huge amounts over a long period to finance investments.

The decisions underlying the strategies of the Wall Street institutions we have mentioned do not only appear questionable to people looking back, or from vantage points outside these businesses and their culture. In the case of Lehman particularly, there were many insiders who openly expressed doubts about Gregory's management of the business and Fuld's loyalty to him.[7] And Fuld's policy of trying to win over external critics of the business to protect its share price exposed him directly to their very substantial grounds for doubt about the strength of Lehman's balance sheet. The question of whether these weaknesses—rather than purely speculative shorting—might be at the source of the decline in the Lehman share price does not appear to have been taken seriously by Fuld until it was too late.

II

We are now in a position to return to the question raised at the beginning: can blame be directed at individuals and institutions in the crisis, and ought it to be? That institutions bear some of the responsibility seems not to be in doubt. The Fed on one hand, and, on the other, a host of financial institutions, all appear to have failed to judge the various risks involved. Sometimes these misjudgments appear to have arisen through misinformation within organizations—as in Citigroup—and sometimes through critically weak accounting methods. In the case of the regulators, the failure seems partly to have arisen from a dogmatic attachment to *laissez-faire* in the financial markets. Another contributing factor may have been successful lobbying by the banking sector.

6. James B Stewart, "Eight Days," *New Yorker* (September 21, 2009): 69–71.

7. Sorkin, 124ff.

Institutional responsibility cannot be the whole story, however, because even competing narratives of the financial crisis agree that many poorly judged policies had identifiable and powerful individual backers or originators high up in some of the different institutions involved. These were no mere bystanders or more or less equal players in a big team effort. Rather, they initiated or gave backing to policies that went wrong; they overruled dissenters lower in the hierarchy; and they sought to placate rather than to listen to big investors and financial journalists who put their fingers on the genuine problems: notably, too much investment with borrowed money, and too much exposure to real estate and real estate–backed securities.

Richard Fuld of Lehman and Sanford Weill of Citicorp presided over very protracted periods at large financial institutions; Stan O'Neall, who led Merrill for a relatively short period, fired thousands of employees and replaced many of its top executives, as well as beginning the policy of highly leveraged investment and concentration on securitized real estate products.[8] He was not single-handedly responsible for all the trouble Merrill got into, but neither was he merely one among many agents whose respective small actions added up to the cause of the firm's problems. On the contrary, his actions were bigger than those of other people in Merrill, and even though the crisis did not reach its peak while he was in charge, the actions he took when he was in a leading role contributed to Merrill's weakness when the crisis came. The same, for reasons already explained, is true of Fuld, and others.

These facts have a bearing on explanations of the crisis that invoke collective responsibility. Although corporations have the kind of unity and organization and deliberative powers that seem to permit ascriptions of responsibility to them and not just to the individuals who work for them, it does not follow that, when institutions *are* responsible, they are responsible to the exclusion of individual responsibility. On the contrary, in corporations where top executives are given considerable discretion to plan, hire, fire, and invest, both the organization *and* individuals at the top can be appropriately praised or blamed.

Not that people at the top of financial institutions or regulatory authorities are solely to blame in the financial crisis. Some people at the bottom of the heap—some with very low incomes who knew that they would not be able to repay big loans, but who took them on anyway—those people, too are blameworthy. So are people in the middle who overborrowed for no better reason that they were keen to make money out of rising house prices or were impatient to finance consumption that could have waited. Still, there is a difference between the irresponsible person at the bottom of the heap and those at the top. The ones at the bottom took the consequences of their imprudence by losing the roof over their heads and their access to credit. Even the disadvantaged who did *not* borrow irresponsibly suffered. This is because the public money that has been used to repair the damage to the financial system has depleted the resources available for the welfare state. In this way the

8. Sorkin. 143ff.

imprudent subprime borrower on a low income has been punished considerably more severely by the financial crisis than even quite irresponsible bank executives. The imprudent subprime borrower has been punished not only with repossession and sometimes personal bankruptcy but also by a thinning of the public safety net that they have come to need more since 2007.

By contrast, many of those at the top of banks that failed have suffered little more than public disapproval and the loss of jobs they did not need in order to live comfortably or better. Top bankers who were fired have remained extremely wealthy. It got much worse for the disadvantaged, but imprudent leading bankers have suffered very little or not at all. Not only have many of them continued to live in luxury, but, as individuals, they also have suffered less and less vilification the more the events summarized in Table 1 have receded into the past.

The condition of the bankers contrasts with that of many other groups of people, even if we disregard those who are most reliant on the welfare state. Among the relatively well off who have reason to resent the bankers are middle-class people whose pensions and other investments lost much of their value through no imprudence of their own; managers and employees in sound small businesses who are affected by the continuing credit shortage; and unemployed but well educated young people whose prospects were worsened by a very long-lasting economic recession in the whole of the developed world. These people, when combined with the worst off, may not add up to 99 percent of the population, as the Occupy movement claims. But they are numerous and have been significantly harmed by the financial crisis.

III

What theoretical understanding of responsibility enables us to make sense of the intuition that leading bankers have been unduly insulated from the consequences of their decisions? I shall make use of a framework that was developed to discuss the apparent insulation of public officials from blame for actions done within their official roles. It may seem that this framework is inappropriate for the responsibility of bankers, since bank executives are not public officials. I shall argue, however, that the framework fits after all, because of the way that the actions of big-bank officials in the early 2000s affected the banking system, and because of the way bank officials sought to sidestep or dismantle regulation that was a key component of that system, and that was partly morally motivated. The banking system has a special public status that executives in the biggest banks, through their ostensibly private sector roles, are sometimes in a particularly good position to damage. The fact that bank executives in the crisis, sometimes self-consciously, acted to change regulation of the system self-interestedly, gives their actions a public dimension. Differently, the fact that some leaders of big banks knew that their banks were systemically linked to other banks through elaborate counterparty arrangements, sometimes involving very large amounts of debt, makes it plausible to say that they were *aware* of

their banks' systemically important status and yet did little or nothing to reduce the risk taking that exposed not only their banks but also the banking system to crisis. In particular, they are open to the criticism of acting unjustly, and not just of making poor or disastrous business decisions.

In order to spell out this line of thought, we need to distinguish big from small banks, banks from the banking system, and also banks from other kinds of big business. The banking *system* in a capitalist economy is supposed to make savings available for productive investment. It is supposed to do this for both individual and commercial borrowers. This intermediation between investors and savers is supposed to occur without loss to savers, and indeed with a return to savers as well as banks. This is supposed to be accomplished by the differential between interest rates charged to borrowers and interest rates offered to savers. Since the class of savers in a developed country can include most of its population, there is a significant overlap between the class of savers and the class of citizens. Again, since a system for holding savings securely is likely to be a precondition of accumulating wealth, and of systematic economic exchange, commercial retail, and wholesale banking—not just central banking—has a claim to be politico-economically fundamental. This distinguishes the banking sector from other business sectors. Furthermore, since personal wealth is both a Rawlsian primary good and an important component of personal welfare, the banking system has a good claim to belong to the Rawlsian basic structure—that is, to belong to the set of institutions involved in the distribution of goods that are available for the realization of Rawlsian life plans.

The banking system is not just the total number of banks interacting with one another and with savings and borrowers, but this together with the relevant regulatory institutions and their enabling and other legislation. In the United States, the regulatory institutions include, as we have seen, the Federal Reserve system at both the national and regional levels, and state regulators. A particularly important piece of legislation for the banking sector before the period immediately leading up to the crisis was the Glass-Steagall Act, which was introduced at the time of the Great Depression, and was superseded in 1999. This Act prohibited U.S. banks of an earlier era from engaging in several of the banking strategies that contributed to the current crisis. These include the following:

1. The development of products—offered in the 2000s through money market funds—that simulate retail bank without being subject to the capital requirements and accounting rules of retail banks;
2. Significant borrowing by banks from other banks, large companies, and sovereign wealth funds to finance investments; and
3. Significant merger and acquisition activity involving retail banks on the one hand and insurance companies and investment dealers on the other.

Not all major banks participated equally in these developments in the decade after 1999. In particular, JPMorgan Chase was considerably less leveraged

than its competitors, and less exposed to real estate.[9] But many major banks that have already been mentioned in our narrative were party to these changes,[10] which together had the effect of weakening the U.S. banking system and not just individual banks.

Because the Glass-Steagall Act was in force for such a long time, there is a sense in which it defined the culture of pre-1999 banking in the United States. Against the background of the Great Depression, the act sought to eliminate lending for speculative investment, and it imposed capital requirements on banks designed to make them able to resist runs. It encouraged lending for "commercial" as opposed to "speculative" investment, and it limited interest rates for savers while insuring their savings up to certain limits.[11] The Wall Street banks collectively, through lobbyists, were important undoers of Glass-Steagall. They supported the Bank Modernization Act. This relaxed or abolished prohibitions on links between commercial and speculative banking. Individual Wall Street banks also lobbied for the relaxation of laws restricting predatory lending as well as bankruptcy.[12]

Not only banks corporately but also individual bankers pressed for deregulation. Foremost among these was Sanford Weill of Citigroup, who was personally involved in the negotiations between the White House and Congress that led to the Bank Modernization Act. It was Weill who hung up in his office a large piece of wood inscribed with his portrait and the legend, "Shatterer of Glass-Steagall."[13] The Bank Modernization Act of 1999 legalized acquisitions and mergers between retail deposit takers, investment banks, and insurance companies. Citigroup was associated with the takeover of Traveler's Insurance before such a takeover was legal. It is hard not to conclude that the Bank Modernization Act, whatever else it may have had to recommend it, was backed by Weill partly because it made possible the creation at Citigroup of a single institution offering the whole spectrum of financial services.[14]

9. Its strength put it almost uniquely into a position to rescue another major financial institution, as it did in the government-assisted rescue of Bear Stearns. Very recently it, too, has been revealed to be involved in the kind of high-risk and highly speculative investments that it prudently avoided at the height of the crisis. Its huge losses in the so-called "London Whale" affair have damaged its reputation at a time when many other tainted banks seem to have begun the return to solvency and profit. See http://www.huffingtonpost.com/2013/04/11/dimon-london-whaleapology_n_3060811.html

10. See Simon Johnson and James Kwak, *13 Bankers*: *The Wall Street Takeover and the Next Financial Meltdown* (New York: Pantheon, 2010), chs 4–6.

11. On the other side, it also permitted a choice for banks between federal and state regulation, a permission that we have seen encumbered measures against predatory lending in the early 2000s.

12. See Deniz Igan, Prachi Mishra, and Thierry Tressel, *A Fistful of Dollars: Lobbying and the Financial Crisis* (IMF Working Paper 09/287, 2009) who give details for Bear Stearns and Bank of America.

13. See http://www.nytimes.com/2010/01/03/business/economy/03weill.html?pagewanted=all

14. The abolition of Glass-Steagall has been proposed as one of the causes of the crisis. See http://mises.org/daily/3098

The influence of at least one banker and many banks on relaxing the rules for the commercial operations of banks; doubtful leveraging policies originating at the top of bank management hierarchies: an over-concentration on assets in or backed by real estate also as a matter of the policies of top bankers: all of these things contribute to an explanation of why individual bankers are appropriate objects of blame after the crisis; and, in particular, why they are appropriately objects of more severe public blame than has actually been directed at them. On one hand, they are guilty of a *morally* objectionable regulatory capture—not just an economically objectionable regulatory capture—that is, one that carries inefficiencies; on the other hand, they are guilty of a kind of imprudence—consisting of high-risk borrowing and lending—that would be considered the height of recklessness in private life, and that is particularly reckless when engaged in through executive decision making within a bank, given that banks are custodians of other people's money, and operate in a legal regime where keeping that money safe is a leading legal requirement.

In order to theorize the injustice of regulatory capture more precisely, we need some apparatus from John Rawls, and in order to theorize personal responsibility for both regulatory capture and high level decision making within banks, we need some apparatus related to Rawls from Thomas Nagel. I come to Nagel later.

The apparatus we need from Rawls is the idea of "basic structure" or the set of institutions crucial to a correctly principled distribution of Rawlsian primary goods.[15] The institutions certainly include courts and legislatures, and also the family.[16] Institutions for regulating the monetary supply and interest rates also seem to be included.[17] But media organizations seem not to belong to the basic structure. They belong to a distinctively pervasive "background culture," which also includes universities and "associations of all kinds."[18]

The idea of the basic structure has been criticized for obscurity and possible incoherence by G. A. Cohen,[19] and I take advantage in my exposition of some of the clarification that this criticism has provoked from defenders of Rawls. In particular, I take over from Andrew Williams the following: (1) that the basic structure is realized by institutions that belong to the "informal structure" of society, and not just the set of coercive institutions;

15. *A Theory of Justice* (Cambridge, MA: Harvard University Press, 1971), §2. See also John Rawls, *Political Liberalism* (New York: Columbia University Press), Lecture VII.

16. See "The Idea of Public Reason Revisited" in John Rawls, *The Law of Peoples* (Cambridge, MA: Harvard University Press, 1991), 156ff.

17. See *Theory of Justice*, 273: "In conformity with political decision reached democratically, the government regulates the economic climate by adjusting certain elements under its control, such as the overall level of investment, the rate of interest, and the quantity of money, and so on. There is no need for comprehensive direct planning. Individual households and firms are free to make their decisions independently, subject to the general conditions of the economy."

18. Rawls, "Public Reason," 134n13.

19. G. A. "Where the Action Is: On the Site of Distributive Justice," *Philosophy and Public Affairs* 26, no. 1 (1997): 3–30.

(2) that the relevant institutions respectively operate by different sets of "public" rules; and (3) that social justice is a matter of selecting that combination of coercive and other informal institutions that secure basic liberties, fair equality of opportunity, and the maximinization of income and wealth.[20]

Now banks seem to belong to the basic structure of a society not because they are coercive but because they, or at least the banking system, belong to the wider "informal" social and economic structure. Again, the banking system seems to belong to the basic structure in respect of its "dispositional" property of having pervasive effects,[21] especially in relation to the maximinization of income and wealth. We have already seen how, when it is in crisis, it can worsen the disadvantage of those at the bottom. But there are also ways in which it can temporarily advantage the worse off—represented in our narrative in the Introduction by subprime borrowers—while eventually disabling coercive basic structure institutions for effecting transfers that would maximinize. Then there are the trade-offs involved in keeping the banking system in equilibrium *à la* Glass-Steagall in normal times: in return for capitalization requirements and ceilings on interest rates that retail banks can offer depositors, there is deposit insurance guaranteed by central government that prevents runs and the loss of large amounts of savings. Competition between savings banks through unregulated interest rate offers for depositors, and in the absence of deposit insurance, left many people penniless in the Depression. Relatedly, buyers of units in money market funds incurred losses when those funds suffered "runs."

Maximinization apart, there is the role of banks in traditional intermediation, that is, in the prudent transformation of savings into investment. It is hard to think of a more fundamental function of the economic system for both individuals (through mortgages) and (through "commercial investment" in the Glass-Steagall sense) for what Rawls calls "associations," including commercial associations, that is, businesses. Of course banks may also have other economically useful commercial functions, such as being sources of sophisticated acquisition and merger strategy for big businesses, and of methods of financing that extend well beyond conventional loans of deposits. Banks are active in the "repo" market, for example. In the period leading up to the crisis, the tendency of banks to be involved in *all* kinds of intermediation, as well as more risky proprietary trading, made them more embedded in the informal basic structure than they might otherwise have been and more of a burden on the formal basic structure, including its legally backed bank regulatory and central banking institutions, when things went wrong.

The role of the banking system and the "systemically important banks" within the basic structure is part of what connects the actions of certain highly placed bankers in big banks with injustice. But what about the personal responsibility, if any, of particular people within these institutions? A

20. Andrew Williams, "Incentives, Inequality and Publicity," *Philosophy and Public Affairs* 27 (1998): 225–47, esp. 234. Maximinization means maximizing the minimum wealth.

21. Williams, 231.

framework that helps to organize our thoughts in this area can be adapted from Thomas Nagel's "Ruthlessness in Public Life."[22] Nagel sets out to show that public office does not insulate officeholders from personal responsibility for wrongdoing committed through their offices. Thus, according to Nagel, Robert McNamara was personally (though not solely) responsible for what Nagel considers to be criminal U.S. military policy implemented during the Vietnam War. He was personally responsible notwithstanding the fact that he was pursuing public ends in a war. According to Nagel, public office does not free office holders from the obligations of ordinary private morality, but the purposes of public offices make results (as opposed to means) count more than they do in private life, and the means of accomplishing these purposes legitimately include powers that would not normally be available for the pursuit of private purposes. These unusual powers may not be used in any way an officeholder likes: law and impartial courts are supposed to constrain office holders. This explains why, for example, shows of partiality or favoritism may be strictly outlawed in public life though they are permissible in private.

The heightened power of public office derives from the public purposes of the office. These public purposes are to bring certain publicly recognized benefits to groups, including nations. Despite the greater latitude given to office holders to pursue such goals as public defense and wealth redistribution through means—notably coercion—that are not open to individuals pursuing their personal goals, it is not permissible for public officials to pursue public goals by whatever means they choose. Avoidable harm and disproportionate mass killing are always impermissible in public office and private life alike; for example, which is why McNamara's acting as Secretary of Defense does not get him off the hook if a military policy leads to a massacre or the targeting of the harmless. In the same way, the fact that any number of bank executives were pursuing a legitimate goal—bank profitability—and facilitating economic growth when they made a policy of reckless leveraging, does not mean that the leveraging was justified after all. Although it is part of the role of chief executive to pursue profitability, it is not part of that role to pursue profitability by high-risk means, and the reasons for avoiding unnecessarily high risk apply in both private and public morality.

In McNamara's case, the public role of Secretary of Defense did not so to speak drown out the contribution of McNamara the man to the execution of defense policy. On the contrary, as Nagel very plausibly claims, the exercise of power through public office can be and often is a means of personal self-expression. Although there are certain effects that any Secretary of Defense tries to bring about, it is permissible to put one's own personal stamp on one's execution of the role, and the possibility of being regarded personally as one of the great presidents or prime ministers is no doubt one of the biggest attractions of those offices. It seems to be similar for leaders

22. Reprinted in Thomas Nagel, *Mortal Questions* (Cambridge: Cambridge University Press, 1979), 75–90.

of big businesses. A successor to Steve Jobs who keeps Apple in profit may for all that live in Steve Jobs's shadow, and other personalities have bigger profiles than even the high-profile companies they lead: Rupert Murdoch and Jeff Bezos might be examples. In the same way, certain banks that were prominent in the financial crisis were themselves run by high-profile executives who put their stamp on their companies. In this respect, personal involvement seems to be as much a feature of leadership in a role in big business as it is in government service.

Now the role of bank chief executive is not necessarily a public role in the way that U.S. Secretary of Defense is: it is not an appointment subject to legislators' vetting of a person's suitability for it, and the interests the post is designed to serve are not primarily those of the public or even the banking sector in general. Nevertheless, it has a strong *public aspect* if decisions made within that role significantly affect the survival of the bank, and the role holder knows that his bank is connected to the banking system in such a way that his bank's failure or some decision of his bank would trigger significant disruption to the whole banking system.[23] In 2008, in New York, the role of chief executive in Lehman, in AIG, in Bear Stearns, and in Citigroup had this strong public aspect. For short periods, the fate of a single bank seemed to determine that of the banking system, and so the commercial obligation of negotiating a rescue became not just a managerial responsibility but a matter of public obligation, too.

The form this took in the United States was that of an obligation to co-operate with the Fed and the U.S. Treasury—agents that were associated with coercive power—for the sake of the survival of the banking system.[24] Sometimes the co-operation required one bank to acquire another; at other times it required a bank to accept government-dictated terms in return for grants and guarantees required for its own survival, and, indirectly, the survival of the banking system. In certain cases, the government's terms proved questionable, because they were particularly advantageous for commercial "rescuers" and because they were influenced by considerations of party-political damage as much as by the survival of the banking system. For example, when JPMorgan took over Bear Stearns, it was initially willing to offer $4 per share, which meant a huge loss for Bear Stearns shareholders. The Treasury Secretary, Hank Paulson, suggested an even lower offer of $2 per share,[25] so as to dispel the impression that the government-assisted rescue by JPMorgan was in any way bailing out Bear Stearns. Since that was exactly the impression that the rescue of Bear Stearns created, the main beneficiary of the Paulson-dictated share price was JPMorgan.

23. The term "systemically important bank" has only been added very recently to regulatory instruments in the United States, the United Kingdom, and globally. For one of the most recent pieces of international guidance, see Bank for International Settlements, "Global Systemically Important Banks: Updated Assessment Methodology and the Higher Loss Absorbency Requirement" (July, 2013), https://www.bis.org/publ/bcbs255.htm

24. In the United Kingdom, similar obligations fell upon executives in Lloyds, RBS, and Northern Rock.

25. Sorkin, 37.

More objectionable than the advantageous terms offered to some banks at the height of the crisis was the effect of bank lobbying on banking law before the crisis. Banks were able to influence in their favor the legal regime governing their operations. This widened the area of the legally permissible in ways that Nagel's model of the constraints on public office holding does not anticipate. Nagel's model treats public offices and associated institutions as in turn constrained by further *independent* institutions, including judicial and legislative institutions, subject to strong norms of impartiality allied to serving the public interest. By being able to lobby for legislative change that was friendlier to the business plans of investment banks and mortgage originators, or combined investment bank/mortgage originators, the banks, both collectively and individually, brought it about that banking legislation did not realize strictly public purposes, but rather the purposes of the banking sector. And some figures in leading positions in the biggest banks were personally responsible for this regulatory capture, as Sanford Weill's wall decoration proclaimed. Regulatory capture reduces the claim of an office with a strong public aspect to insulate its holders from responsibility for what is done through that office. In this way, individual bankers may be more guilty than McNamara, though of wrongdoing that is less than lethal.

IV

The upshot of the position being argued for in this article may appear to be close to that of some journalistic pilloryings of the bankers, such as *Time* Magazine's "25 People to Blame for the Financial Crisis."[26] It is true that some of the people already mentioned figure in *Time*'s list. Sanford Weill and Richard Fuld do; so does Alan Greenspan. I agree that these people have personal responsibility (though of course not sole responsibility) for elements of the financial crisis. But there are important points of difference between the approach behind the *Time* list and my own, which accounts for some disagreements between a list that would be suggested by this article and the list suggested by *Time*.

Time sometimes chooses an individual to *personify* a regulatory institution or bank. So, for example, Chris Cox is high on its list of blameworthy people, because he was in charge of the Securities and Exchange Commission (SEC) at the time of the crisis, and it was within the power of the SEC to require more prudent leveraging from the banks. In this case my approach would be to ask whether in fact Chris Cox *was* the SEC in any important sense. The more powerful and long-lived the leader, the more the leader's strategy is the bank's or regulatory institution's strategy, then the more personification makes sense. But it does not follow from the fact that someone is in charge that they *are* the organization in any interesting sense. So I am

26. See http://www.time.com/time/specials/packages/article/0,28804,1877351_1877350_1877339,00.html

not sure that on my approach Cox is important to mention. (The SEC already has been mentioned.) Distinctions can also be made between bankers on *Time*'s list. In particular, Stan O'Neall was not related to Merrill as either Richard Fuld or Sanford Weill were related to Lehman or Citigroup, respectively. The latter two do have some claim to have personified the organizations they led. In the case of O'Neall, that is not so. So while all three bear personal responsibility on my account as well as *Time*'s, O'Neall has a weaker claim to be on the list, or a claim to be on the list different from Fuld and Weill, because he did not personify Merrill.

An important problem for *Time*'s approach emerges when one comes to the "person" listed fifth in its register of the blameworthy. This turns out to be no individual at all but rather "American consumers." Why this group counts for only one in the list of twenty-five is unclear. Surely, it ought to expand the number on the list from twenty-five into the hundreds of millions. In any case, here is what *Time* says about this class of guilty people:

> In the third quarter of 2008, Americans began saving more and spending less. Hurrah! That only took 40 years to happen. We've been borrowing, borrowing, borrowing—living off and believing in the wealth effect, first in stocks, which ended badly, then in real estate, which has ended even worse. Now we're out of bubbles. We have a lot less wealth—and a lot more effect. Household debt in the U.S.—the money we owe as individuals—zoomed to more than 130 percent of income in 2007, up from about 60 percent in 1982. We enjoyed living beyond our means—no wonder we wanted to believe it would never end.[27]

My account has also mentioned individual borrowers who knowingly speculated on the property market rather than invested in a place to live, and those who would not defer consumption until it was within their means. But these people do not add up to the class of American consumers, even if most Americans or many Americans are in debt and do not save enough. Again, many of the people who speculated and who should have deferred consumption do not, on my account, deserve public blame. Many of them personally suffered the consequences of their imprudence—through personal bankruptcy or repossession of their houses. Public blame *in addition* is unnecessary.

My account has focused on those whose actions were much more far-reaching, whose imprudence was much more damaging than that of the small-scale property speculator, and who have not had to cope with much more unpleasantness as a result than being included in a list like *Time*'s. These people have gotten off unduly lightly, on my account. Still, the number of people in the group of well off and seriously damaging agents is probably not very large. It is certainly much smaller than the class of American banking executives, smaller even than the class of American executives in companies

27. See http://www.time.com/time/specials/packages/article/0,28804,1877351_1877350_1877319,00.html

as central to the crisis as Countrywide or Citigroup, for even in those organizations there were people in powerful roles who could see big risks and who tried and failed to get things done differently. My account is geared to what I called the *strong public aspect* of decisions in banks that were able to affect the whole banking system. My account directs serious blame at relatively few people, people whose roles—I hope to have shown—are inevitably strongly publicly aspected ones, even though they are discharged in the private sector.