

**THE SCANDAL BENEATH THE FINANCIAL CRISIS:
GETTING A VIEW FROM A MORAL-CULTURAL
MENTAL MODEL**

KEVIN T. JACKSON*

“We have met the enemy, and he is us.”

—Walt Kelly

INTRODUCTION	736
I. RECEIVED VIEW OF THE FINANCIAL CRISIS	740
A. What Happened and Why?	741
B. What Regulatory Responses Are Called For?	743
C. Taking Another Perspective, and Posing a Further Question	744
II. CRITICAL EXEGESIS OF MENTAL MODELS	745
A. Mental Model of the Economist	745
B. Business Management Mental Model	747
C. Mental Model of Lawmakers and Legal Authorities	753
D. Moral-Cultural Mental Model	755
1. Moral Virtue	759
2. Human Dignity	761
3. The Common Good	763
III. MORAL-CULTURAL DYSFUNCTIONS INDICATED BY THE CRISIS THAT ARE NOT TREATABLE BY LEGAL REGULATION	764
A. Post-Modernism	764
B. Rise in Speculative Culture	766

* Professor of Business Law and Ethics, Fordham University School of Business; Senior Fellow, The Witherspoon Institute, Princeton, New Jersey; B.A., 1978, M.A., 1985, Florida State University; J.D., 1981, Florida State University College of Law; Ph.D., 1990, University of Maryland at College Park.

C. Egoistic Individualism.....	767
IV. SAFEGUARDING MARKET ECOLOGY	769
A. Moral Coordination	770
1. Adam Smith.....	770
2. Friedrich Hayek	771
B. No Bailout for Loss of Reputational and Social Capital.....	775
CONCLUSION.....	777

INTRODUCTION

When diagnosing the financial crisis one should take care in framing the terms of discourse. Ever since the signs of economic collapse began appearing, it has been commonplace for pundits as well as the general public to call the fiscal meltdown a “crisis,” a term that conveniently carries no ascription of moral disapprobation. Yet after one has reckoned the extensive list of both personal and corporate malfeasances that have played a significant role in precipitating the financial turmoil and paid heed to the underlying moral-cultural factors accompanying the wrongdoing, a more apt description would be “scandal,” a term that implies some degree of moral-cultural failure.

This is not idle quibbling over terminology. Most people would agree that it is of critical importance whether an economic downturn is branded a “recession” or a “depression.” There are significant political consequences of using one term or the other. Similarly, it matters whether we characterize the global financial imbroglio in amoral (scientific) or moral (human-oriented) terms. It matters whether we approach the crisis with the attitude that we can understand it simply by looking at economists’ equations and statistical analyses, annexed to business managers’ technocratic jargon, or, instead, we decide that by looking beyond these mental models to the broader realm of moral and intellectual culture we can achieve a more satisfactory understanding.

Looking at the financial scandal from a moral-cultural frame of reference reveals a moral-cultural malaise, and it matters how we respond to this condition.¹ Do we acquiesce to legisla-

1. These assertions, admittedly, are controversial. To those who insist on describing the financial crisis in purely functionalist and scientific terms they may

tors' attempts to promulgate new laws and regulations? This response is common, but it ultimately cedes responsibility for solving the dysfunctions behind the crisis to legal authorities. This Article argues that this approach is inadequate. We would do better to act as if the crumbling of the current economic edifice is a massive chastening, with a call for deepened moral reflection and reform. We ultimately have no one but ourselves to blame for this economic collapse, and there is no one else to whom we can look to chart a new course to prosperity.²

The use of the amoral word "crisis" to characterize the meltdown likely flows from an ingrained habit of viewing the world of business in general, and financial markets in particular, as if they operated according to the same kind of mechanistic, determined, and repeatable behavior, like the chemical reactions that scientists study in the laboratory. Those disposed to explain market phenomena with a positivist mindset, who see the business of business as business, in some cases reduce both the symptoms of and the cure for today's credit malaise to mathematical equations.³ Sometimes they diagnose the problem in squarely scientific, even medical terms,⁴ as evidenced by

appear absurd. There is no conclusive argument to support the basic contention that a broader mindset offers greater insight into both understanding the phenomenon and developing practical responses that are likely to enhance business success in the broad sense. It is likely that other attempts at analyzing, and proposing solutions to, the financial crisis are even less satisfactory.

2. Although written in the midst of the rise of totalitarian regimes posing a threat to free institutions, the following words sound equally germane to the present global financial crisis: "We are ready to accept almost any explanation of the present crisis of our civilization except one: that the present state of the world may be the result of genuine error on our own part and that the pursuit of some of our most cherished ideals has apparently produced results utterly different from those which we expected." F.A. HAYEK, *THE ROAD TO SERFDOM: TEXTS AND DOCUMENTS*, 65–66 (Bruce Caldwell ed., Univ. of Chi. Press 2007) (1944).

3. Dependence modeling with the use of copula functions is commonly used in financial risk assessment and actuarial analysis—for instance, in the pricing of collateralized debt obligations (CDOs). A methodology of applying the Gaussian copula to credit derivatives, as formulated by David X. Li, has been cited among factors contributing to the financial crisis. See Felix Salmon, *A Formula for Disaster*, *WIRED*, Mar. 2009, at 74, 74–75.

4. For instance, consider the term "global contagion." In the context of economic analysis, the word "contagion" expresses the effect of financial calamities spreading from one institution to another. For example, a run on a bank can expand from a few banks to many others. Similarly, a financial crisis can spread from one country to another, as in the case of currency crises, sovereign defaults, or stock market crashes advancing across borders. Another example of medical jargon is "transfusion." In an online commentary, Boston University's School of Manage-

the quick \$700 billion and \$2.3 trillion prescriptions of government leaders in the United States and Europe respectively.⁵ In line with such viewpoints, we have heard many talk of how the economic meltdown was precipitated by a falling real estate market, the product of recurring bubbles that appear every ten or twenty years.⁶ According to this account, fundamental dynamics in housing and property markets lead to speculative bubbles that inevitably bring financial systems down with them—no matter what kinds of systems they are—because financial systems are heavily involved in mortgage lending. Even those systems that do not have substantial securitization and are not dominated by private banks are susceptible to those trends.⁷ But using the reductive mathematical and scientific explanations of some economists and business theorists to account for the present financial crisis may turn out to be as serious a delusion as the false belief peddled by the current administration that government bailouts, coupled with the geyser of regulations that has been gushing from congressional committees, can fix it.

This Article argues that, although it is necessary to ground any meaningful discussion of the financial crisis in the received views of economists, business managers, and legal experts, gaining a deeper understanding of the current financial predicament requires that one advance beyond the mental models upon which such viewpoints are based and adopt the perspective of a moral-cultural mental model (MCMM) as well. Indeed, such a vantage point is essential for discerning the lessons for enlightened business leadership going forward. From an MCMM point of view, several causes of the present economic crisis, particu-

ment Dean Louis Lataif stated that “[t]he public is beginning to see bailouts as ‘transfusions,’ rather than a closing of the wound, and is losing patience with them.” Posting of Louis Lataif to The Great Debate, <http://blogs.reuters.com/great-debate/> (Mar. 23, 2009, 14:26 EDT).

5. See Editorial, *Making it worse; Government should stop using credit card to postpone financial day of reckoning*, COLUMBUS DISPATCH, Oct. 16, 2008, at 8A; Angela Charlton & Emma Vandore, *Europe puts more on the line for banks than US*, USATODAY.COM, Oct. 13, 2008, http://www.usatoday.com/money/economy/2008-10-13-2102616413_x.htm.

6. Richard Herring & Susan Wachter, *Bubbles in Real Estate Markets* (Zell/Lurie Real Estate Ctr., Working Paper No. 402, 2002), available at <http://realestate.wharton.upenn.edu/newsletter/bubbles.pdf>; Knowledge@Wharton, Hope, Greed and Fear: The Psychology behind the Financial Crisis, <http://knowledge.wharton.upenn.edu/article.cfm?articleid=2204> (last visited Jan. 19, 2010).

7. Herring & Wachter, *supra* note 6.

larly financial innovation and complexity, excessive executive compensation, and neglect of moral hazard, are seen to be rooted in deep-seated moral-cultural tendencies. Most notable among these are technocratic and dehumanized economic thinking, egoistic individualism, greed, short-termism, rejection of objective moral values, and a highly speculative culture.

These underlying moral-cultural trends cannot be resisted or reversed simply by increased law and regulation. Instead, they must be addressed by more nuanced ethical thinking and collective activity grounded in virtue, regard for the common good, and respect for the long-term preservation of market ecology, as well as by paying greater attention to the cultivation of intangible capital assets such as reputational and social capital. Our thinking needs to be more sensitive to the complexity of the relationship between ethics and economics and more attuned to the importance of trust, truth, and transparency. We must also establish localized and spontaneous social structures that are better equipped to foster such elements in business conduct than stepped-up regulation ever could.

Part I presents a brief account of the emergence of the financial crisis, drawing upon the received views of leading economists, businesspersons, and legal experts. Part II first offers a critical exegesis of the three chief conceptual models that have framed these received reactions to the calamity: the paradigms of economics, business management, and legal regulation. Second, it argues that in light of the limitations of these three mental models, an alternative moral mental model is of particular importance. Third, it distinguishes a natural law oriented moral framework, based on virtue, dignity, and the common good, from mainstream "business ethics" frameworks. Current business ethics models are deficient for these reasons. First, they tend to be based on the idea that if it is not illegal, it is acceptable. Second, they fail to seriously engage moral right and wrong because of their immersion in moral relativism. Third, they are dominated by window dressing, political-correctness, and anti-business agendas. Part III identifies the existence of a moral-cultural malaise lurking beneath the financial crisis. This general condition is characterized by a post-modern moral relativism and rejection of traditional values (both economic and moral), a rise in speculative culture, and egoistic individualism. Moral reform focused on virtue, dignity, and the common good, rather than legal regulation, is the appropriate response to these factors. Part IV introduces the concept of

“market ecology,” and relates it to the idea of the common good. I highlight a number of key moral malfeasances connected to the financial crisis to illustrate the harm such practices inflict on the ecology of the market so conceived. This Article concludes that, instead of looking only to the adoption of new legal regulations, visionary corporate governance ought to take greater cognizance of cultivating virtuous, dignity-respecting behavior directed at the common good, which will create favorable background moral conditions for sustaining the ecology of the market.

I. RECEIVED VIEW OF THE FINANCIAL CRISIS

Looking at the economic crisis prompts some important questions: What happened? Why did it happen? What sorts of regulatory responses are called for? This Part will provide a brief sketch of widely recognized responses to these questions and will proceed in the terms of the conventional discourse of economists and legal experts.

We live in a world of mental models.⁸ To oversimplify for the sake of illustration, we could say that the mental model of the economist inclines him to look for mathematical formulas. Similarly, the mental model of the business management theorist leads him to seek causal scientific explanations. The mental model of the legal expert inclines him to suggest new laws and policies to “fix” the problem at hand. We have heard a lot of discussion about the financial crisis from each of these respective models. This Part will briefly summarize the distinctive ways in which these mental models have framed the financial crisis.⁹

8. See William B. Rouse & Nancy M. Morris, *On Looking Into the Black Box: Prospects and Limits in the Search for Mental Models*, 100 *PSYCHOL. BULL.* 349, 349–63 (1986); Patricia H. Werhane, *Exporting Mental Models: Global Capitalism in the 21st Century*, 10 *BUS. ETHICS Q.* 353, 354 (2000).

9. Of course, many other mental models exist and represent important perspectives from which to address the financial crisis. For instance, the mental model of the politician looks for the most expeditious way of getting through public matters. Consider the account of Federal Reserve Chairman Ben Bernanke (both an economist and a politician) in February, 2008: “I expect there will be some failures,” but “[a]mong the largest banks, ratios are solid.” *Fed Chairman: Some Small US Banks May Go Under*, CNBC, Feb. 28, 2008, <http://www.cnbc.com/id/23390252/>. Seven months later, in a dramatic meeting in September, 2008, Bernanke, along with Treasury Secretary Henry Paulson, met with key legislators. In Bernanke’s alarming words, “[i]f we don’t do this, we may not have an economy on Monday.” Joe Nocera, *36 Hours of Alarm and Action as Crisis Spiraled*, N.Y. *TIMES*, Oct. 2, 2008, at A1. The purpose of this depiction was political expediency—to pressure Congress into approving a \$700

A. What Happened and Why?

Leading economists and business writers have asserted that the recent financial meltdown represents the most severe economic downturn since the Great Depression.¹⁰ The crisis has had global consequences: collapses of major businesses, sizeable reductions in personal wealth, extensive financial commitments taken on by governments, and a substantial downturn in economic activity. Economists and business experts have offered an array of explanations concerning the origins of the crisis.

For many economists, the proximate trigger of the financial turmoil was when the United States housing bubble popped after reaching its apex in 2005 and 2006. Soon after the bubble burst, the default rates on subprime and adjustable rate mortgages began to mount. Enlargements of loan incentives, particularly favorable initial terms, and a long history of rising housing prices had prompted borrowers to take on burdensome mortgages in the hope that they could readily refinance at more affordable rates. Yet when interest rates started rising and housing prices began dropping across the United States during 2006 and 2007, refinancing proved harder. Defaults, followed by foreclosure actions, increased appreciably as comfortable initial terms ended, house

billion emergency bailout. The rhetoric worked. Within a month, on October 3, 2008, the Emergency Economic Stabilization Act created the Troubled Asset Relief Program (TARP). Pub. L. No. 110-343, 122 Stat. 3765 (2008).

The fatal limitation of the politician's mental model is that it is ill-equipped to capture any sense of the common good. Narrow special interests are stronger and more vocal, and there is a paralyzing lack of consensus regarding national priorities. Politicians normally operate on a confrontational basis, as reflected in the opposition of labor versus management, business versus government, and environmentalism versus economic growth. Political rhetoric is characteristically framed in terms of "battles" and "wins or loses," as if a win for one group is always a loss for another. Special interest groups, such as the American Medical Association, the National Rifle Association, the National Education Association, feminists, pro-choice groups, and pro-life groups, gather to push for their narrow objectives. The problem, then, in the context of the financial crisis, is that the discourse of contemporary politicians based on expediency and confrontation tends to foster poor communication, distrust, and cynicism at a time when listening, cooperation, and compromise would be more conducive to moral leadership.

10. See, e.g., Eugene A. Ludwig, *Act 3 of Crisis Is Over. Get Set for Act 4*, AM. BANKER, Dec. 18, 2009, at 9; Robert J. Samuelson, *Economists undone by their ignorance of history*, TORONTO STAR, July 15, 2009, at A19.

values did not increase as expected, and rates on adjustable rate mortgages were recalibrated at higher rates.¹¹

Before the crisis, substantial sums of money had been pouring into the United States from rapidly growing foreign economies. The heavy influx of funds, coupled with low rates of interest in the United States from 2002 to 2004, tended to ease credit conditions. The easing of credit, in turn, led to the inflation of housing bubbles and credit bubbles alike. Because of the ease with which a variety of loans could be obtained, especially those for automobiles, mortgages, and credit cards, consumers built up an unparalleled debt burden.¹² The magnitude of mortgage-backed securities, which acquire their value from mortgage payments and home prices, also intensified. These forms of financial innovation permitted investors and institutions across the globe to invest in the United States housing market. When housing prices fell, large global financial institutions that had borrowed and invested heavily in subprime mortgage-backed securities started reporting major losses.¹³ In addition, declining prices caused houses to become valued below the amount of their mortgage loans. Owners then had a financial incentive to abandon the houses, leading to foreclosures. The rash of foreclosures that began in the United States at the end of 2006 depleted consumer wealth and abraded the power of financial institutions. In addition, defaults and losses on other types of loans escalated as the upheaval spread from the housing market to other sectors of the economy.¹⁴

As the credit and housing bubbles grew, a dynamic took hold whereby the financial system was expanding while simultaneously becoming more and more fragile. In the main, policymakers did not perceive the significant role of the financial institutions that made up the so-called shadow banking system, especially hedge funds and investment banks.¹⁵ In the eyes of some experts, such institutions became as significant as retail depository banks

11. See Kevin G. Hall, *Not another real-estate crisis: Commercial mortgages next?*, *MCCLATCHY*, Apr. 30, 2009.

12. *The intersection of Main and Wall*, *GLOBE & MAIL* (Canada), Oct. 1, 2008, at A20.

13. See Nick Onnembo, *U.S. financial system: Can it collapse?*, *TELEGRAM & GAZETTE* (Mass.), June 13, 2008, at 8.

14. See William Poole, *Causes and Consequences of the Financial Crisis of 2007–2008*, 33 *HARV. J.L. & PUB. POL'Y* 422, 426 (2010).

15. PAUL KRUGMAN, *THE RETURN OF DEPRESSION ECONOMICS* 158 (2009).

in supplying credit for the United States economy.¹⁶ Not only were such institutions exempt from the regulations that applied to depository banks, but, together with some regulated banks, they had taken on substantial debt loads while making loans. Yet they lacked financial cushions adequate to withstand large loan defaults or mortgage-backed securities losses. Such losses dampened the capacity of financial bodies to extend loans, which consequently tended to slow economic activity.¹⁷ Doubts surrounding the solidity of key financial organizations led central banks to extend funds to stimulate lending and shore up confidence in commercial paper markets, which are vital to supporting business operations. The government has intervened to bail out major financial establishments and has rolled out economic stimulus initiatives, taking on enormous financial obligations ranging from asset purchases, guarantees, and loans, to direct spending.¹⁸

B. *What Regulatory Responses Are Called For?*

Beyond the government bailouts, and in line with the picture of the crisis presented by leading economists, influential legal experts have proposed a wide array of market-based and regulatory solutions, a number of which have either been put into action or are still being contemplated. What follows is a short, non-exhaustive summary of the regulatory proposals.

Generally, the regulatory proposals have been aimed at reducing the impact of the current crisis and preventing recurrences. The proposals have targeted a host of issues, including executive pay, financial cushions, consumer protection, the regulation of derivatives and the so-called shadow banking system, and the power of the Federal Reserve to wind-down systemically significant financial institutions. In particular, some of the more prominent regulatory proposals have included allowing debt-for-equity swaps to reduce mortgage balances for struggling homeowners,¹⁹ requiring minimum down payments together with income verifi-

16. Kenneth Howe, *A year on, and Lehman fallout still being felt around the world*, S. CHINA MORNING POST, Sept. 14, 2009, at 1.

17. Alan Greenspan, *We need a better cushion against risk*, FIN. TIMES, Mar. 27, 2009, at 11.

18. Rick Newman, *The Private Sector Gets Another Chance*, U.S.NEWS.COM, Nov. 2, 2009, <http://www.usnews.com/money/blogs/flowchart/2009/11/02/the-private-sector-gets-another-chance>.

19. Tom Petrino, *Mortgage Forgiveness May Be Next*, L.A. TIMES, June 27, 2009, at B1.

cation to inhibit the proliferation of “liar loans,”²⁰ nationalizing major banks,²¹ establishing rules to insulate investors and financial institutions from systemic risk,²² imposing constraints on executive compensation so as to reward long-term performance rather than excessive risk-taking,²³ regulating institutions that “act like banks” in ways similar to how banks are regulated,²⁴ breaking up financial institutions that are “too big to fail” to mitigate systemic risk,²⁵ returning to the separation of retail depository banking and investment banking established by the Glass-Steagall Act of 1933,²⁶ establishing resolution or wind-down procedures to sort out liabilities of failed investment banks and hedge funds,²⁷ requiring banks to maintain a stronger capital cushion with graduated regulatory capital requirements,²⁸ and requiring that standardized derivative contracts be traded on regulated exchanges.²⁹

C. Taking Another Perspective, and Posing a Further Question

A vital question remains. It is a question that economists, management theorists, and legal experts are not well suited to tackle. This intractable question is: What are the implications of the crisis for business leadership? For reasons laid out in the next Part, addressing this question requires us to probe deeper than the received views of economists and legal authorities by

20. See Irwin Stelzer, *Weak Housing Threatens to Slow Economy*, SUN. TIMES (London), Mar. 25, 2007, at B4.

21. Peter S. Goodman, *Taking the pulse of an America that has always Felt Lucky: Populist anger amid crisis may sharpen appetite for more regulatory oversight*, INT’L HERALD TRIB., Sept. 21, 2009, at 18.

22. Vikram Khanna, *Sub-prime: six lessons, and counting*, BUS. TIMES SING., Mar. 7, 2008.

23. Andrea Fuller, *House Backs Limits on Pay To Executives*, N.Y. TIMES, Aug. 1, 2009, at B1.

24. Richard Northedge, *Make banking boring to avoid boom and bust*, INDEP. ON SUNDAY (London), Mar. 15, 2009, at 82; see also, KRUGMAN, *supra* note 15, at 163.

25. Irwin Stelzer, *If a bank is too big to fail, it must be broken up: None of the planned banking reforms protects the financial system*, DAILY TELEGRAPH (London), July 29, 2009, at 19.

26. David Prosser, *The question Obama can’t quite face*, INDEP. (London), Sept. 15, 2009, at 34.

27. David Ignatius, Editorial, *The View From the Eye of the Storm*, WASH. POST, July 18, 2008, at A17.

28. Boyd Erman, *Europe, U.S. at odds over bank capital ratios; Split emerges over how much more is needed; European banks could be less competitive*, GLOBE & MAIL (Canada), Sept. 24, 2009, at B4.

29. See *Reforming America’s financial system*, INT’L HERALD TRIB., Sept. 15, 2009, at 6.

adopting the MCMM. First, however, this Article provides a critical exegesis of prevailing mental models of economists, management theorists, and legal experts.³⁰

II. CRITICAL EXEGESIS OF MENTAL MODELS

Mental models provide the conceptual lenses through which we see the world.³¹ Accordingly, depending on how they are put to use, such lenses serve either to clarify or to distort our view. The mental models of economics, business management, and law have equipped us with knowledge to comprehend and to manage, albeit in an imperfect and limited way, complex financial systems and institutions. But are they adequate? Have they warped our vision in some important way?

A. *Mental Model of the Economist*

Although economists have the most to say about the causes of the financial crisis, they have been squarely faulted for the inability of their econometric models to predict the crisis.³² The

30. Of course, not *all* economists, management theorists, and legal experts operate with the mental models herein diagnosed.

31. See THOMAS S. KUHN, *THE STRUCTURE OF SCIENTIFIC REVOLUTIONS* 175 (2d ed. 1970). Professor Kuhn uses the term “paradigm” to explain how fields of knowledge are based upon shared systems of belief that are defined by a common vocabulary and a set of accepted problems and agreed-upon solutions. Thus, on the one hand, a paradigm defines a community of belief; on the other hand, communities of belief do not exist but for the shared beliefs, acknowledged problems, and recognized solutions that constitute a paradigm. Although Professor Kuhn’s book was aimed at the history of changes in the physical or “hard” sciences, John Kenneth Galbraith articulated a similar idea that is closer to the context of the present discussion: “The first requirement for an understanding of contemporary economic and social life is a clear view of the relation between events and the ideas which interpret them.” JOHN KENNETH GALBRAITH, *THE AFFLUENT SOCIETY* 6 (4th ed. 1984).

32. Interestingly, Wilhelm Röpke makes a similar observation: “A few months before the beginning of the greatest economic crisis in history, in the spring of 1929, the most distinguished American economists were talking about the happily secure equilibrium of an economy running in top gear.” WILHELM RÖPKE, *A HUMANE ECONOMY* 250–51 (1960). One magazine article stated that economist Nouriel Roubini had presaged the economic downturn as far back as September of 2006, but added that the field of economics is not well equipped to foretell a recession. Stephen Mihm, *Dr. Doom*, *N.Y. TIMES*, Aug. 17, 2008 (Magazine), at 26; see also, Emma Brockes, *He Told Us So*, *GUARDIAN* (London), Jan. 24, 2009, at 24. For other accounts of experts providing signals of an impending crisis, see *Recession in America*, *ECONOMIST*, Nov. 17, 2007, at 385, and Kabir Chibber, *Goldman Sees Subprime Cutting \$2 Trillion in Lending*, *BLOOMBERG*, Nov. 16, 2007, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aXHulkIznCr0/>.

economics profession has also been criticized on the ground that the financial modeling it has used since the mid-1990s may have led a substantial number of banks and financial institutions to commit improprieties.³³

Whatever the merits of such accusations, the key explanatory limitation of the economist's mental model is this: Economics is becoming so excessively mathematical that its human element is being eclipsed.³⁴ Yet the human dimension is precisely where we must look to achieve moral and cultural reform. In the wake of the financial crisis, the mental model of the economist, when directed toward the world of business, is deficient to the extent that it overlooks the fundamental complexity of human nature that is at the core of economics and business, properly understood.³⁵

In a trend that originated during the time of John Maynard Keynes, ordinary economic theorizing has gradually become oriented towards mathematics and quantification.³⁶ The evidence supporting this claim is readily available from a random walk through the stacks of any library to inspect leading journals of economics. Even a cursory examination reveals the superfluity of quantitative formulas, statistical analyses, and algebraic equations that typify the thought processes of conventional economics.³⁷ The profusion of quantitative detritus seems to issue forth whether its instigators are neo-Keynesian disciples or adherents of the efficient markets hypothesis.³⁸ Yet a major deficiency of this intellectual trend is

33. See, e.g., Frank Rich, Op-Ed., *The Other Plot to Wreck America*, N.Y. TIMES, Jan. 10, 2010, at WK10.

34. This critique of the mathematization of economics has been advanced by such thinkers as Friedrich Hayek, Robert Heilbroner, and John Maynard Keynes.

35. See R. Edward Freeman & David Newkirk, *Business as a Human Enterprise: Implications for Education*, in RETHINKING BUSINESS MANAGEMENT: EXAMINING THE FOUNDATIONS OF BUSINESS EDUCATION, 131, 139–43 (Samuel Gregg & James R. Stoner, Jr. eds., 2008).

36. See, e.g., PAUL ANTHONY SAMUELSON, FOUNDATIONS OF ECONOMIC ANALYSIS 5–6 (1947).

37. As Röpke puts it: "When one tries to read an economic journal nowadays, often enough one wonders whether one has not inadvertently picked up a journal of chemistry or hydraulics." RÖPKE, *supra* note 32, at 247.

38. As Nobel Prize economist Myron Scholes stated, "[t]here are models, and there are those who use the models," referring to the distinction between "ivory tower" economists who concoct models and financial engineers who apply the models to the actual business world. *Efficiency and beyond*, ECONOMIST, July 18, 2009, at 368. Of course, a number of economists who embrace the efficient markets hypothesis posit some modifications to it as a consequence of their readiness to

that it effectively conflates the study of economics with but one instrument of economic examination. As Albert Einstein is supposed to have put it: "Not everything that can be counted counts, and not everything that counts can be counted."

As symbolic language that originally developed as a method for examining natural science, mathematics is well suited to the study of the natural world. It is also an effective means of representing comparatively steady and straightforward economic patterns. But mathematics is not as suitable for examining a broad range of phenomena—such as institutions, values, culture, and traditions—that clearly have an enormous bearing on economic life. In other words, it is highly dubious that the mental model of quantitatively oriented economics is an adequate intellectual framework for understanding the entire range of economic life, given all of its instabilities, complexities, and uncertainties.

Granted, economics can achieve sound results by deploying mathematics when explaining relationships that have distinctively quantitative features. But as economics continues to examine the world in almost purely quantitative terms, it tends to neglect the human side of things, which is to say, the part that is non-mathematical and that does not behave according to fixed laws. In the words of Wilhelm Röpke: "Economics is no natural science; it is a moral science and as such has to do with man as a spiritual and moral being."³⁹ Röpke's insights point directly to a fundamental limitation of the mental model of the contemporary economist. In its quest for formulas, the "new economics," especially as it is enshrined in "financial engineering," is gradually eroding our comprehension of economics as a "moral science."⁴⁰

B. Business Management Mental Model

The rise of a narrow positivism or scientism in theories of business management has accompanied the mathematization of economics. Like the economists, business researchers have typically misdirected scientific methods by incorrectly assuming that the subject of their investigations—the world of business—closely resembles the physical sciences. They thus

accept findings from other fields of study, such as psychology, in an effort to account for seemingly irrational economic behavior on the part of both individuals and institutions. *See id.*

39. RÖPKE, *supra* note 32, at 247.

40. *Id.*

wrongly believe that business unveils itself as an objective phenomenon governed by repeatable and predictable processes. Associated with this positivistic outlook is the further assumption that the only legitimate objective of business is maximization of shareholder value.⁴¹ How did such a restrictive narrative about business come about in the first place?

In answering this question, it is helpful to consider some points that emerged from a recent, penetrating study of business education by Rakesh Khurana.⁴² He maintains that the need to “professionalize” business schools was connected, as in the disciplines of engineering and medicine, with a need to convey knowledge that would function as a wall around the profession and thus keep the amateurs out of the picture.⁴³ Yet unlike fields such as engineering or medicine, the exact content of that specialized knowledge remained obscure until 1959, when the Rockefeller, Carnegie, and Ford Foundations began to devote extensive resources to the development of technical subjects at business schools such as linear programming and statistical quality control.⁴⁴ Underpinning this project was the assumption that introducing mathematics-infused social science into the curriculum would accord an aura of academic respectability to business schools. Thus, for instance, business faculty would be recruited, hired, and tenured according to their production of scientific publications. Khurana points out the irony that, from the 1970s on, this scientific turn led innovative business schools to embrace the agency theory that was itself an outgrowth of neoclassical economics. The widespread acceptance of agency theory’s seductive language, which was seen as useful for understanding a world in which business organizations, ownership, markets, and technologies are constantly in flux, served to dissolve traditional ideas of responsibility. According to this academic paradigm, managers are agents whose interests are not necessarily aligned with those of the principals, meaning the owners of a firm, the shareholders. The company is seen as a mere

41. See Freeman & Newkirk, *supra* note 35, at 138.

42. RAKESH KHURANA, FROM HIGHER AIMS TO HIRED HANDS: THE SOCIAL TRANSFORMATION OF AMERICAN BUSINESS SCHOOLS AND THE UNFULFILLED PROMISE OF MANAGEMENT AS A PROFESSION (2007).

43. *Id.* at 176–92.

44. Pablo Triana, *Why Business Schools Are to Blame for the Crisis*, July 13, 2009, BUS. WK. ONLINE, http://www.businessweek.com/bschools/content/jul2009/bs20090713_635092.htm.

legal fiction, a “nexus of contracts.”⁴⁵ Within the nexus-of-contracts theory, however, there is no place for a corporate ethos or corporate responsibility. Managers pursue their own advantage rather than the good of the company, much less the community’s welfare.⁴⁶ For instance, managers have incentives to magnify their compensation by increasing the size of the enterprise and expanding the reach of their responsibility, even when there is no profit to be gained from this kind of arrangement.⁴⁷

Agency theory emphasized monitoring management performance and providing incentives for managers to improve business performance. Various financial innovations that emerged in the 1970s and 1980s, such as the deployment of leveraging and debt in restructuring business organizations, accordingly enjoyed a compelling justification in terms of heightened efficiency.

As a legacy of this approach, the dominant focus of business management today is on the model of large, publicly traded corporations that present a complex agency problem in which managers occupy the role of shareholders’ agents. Within the field of business management, theories of social science take center stage, while business people act as if corporations and agency problems are virtually immune from any consideration other than shareholder value. According to Sumantra Ghoshal:

In courses on corporate governance grounded in agency theory, we have taught our students that managers cannot be trusted to do their job[]—which, of course, is to maximize shareholder value In courses on organization design, grounded in transaction-cost economics, we have preached the need for tight monitoring and control of people to prevent “opportunistic behavior.”⁴⁸

Thus, underpinning a great deal of the management discussion is a positivistic and deterministic outlook on business. This interpretive mindset is persuasive in consulting, securities trad-

45. See JOHN R. BOATRIGHT, *ETHICS IN FINANCE* 176 (1999); R.H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 388, 391–93 (1937).

46. Kelley Holland, *Is It Time to Retrain B-Schools?*, *N.Y. TIMES*, Mar. 15, 2009, at BU1.

47. *But see* Christopher Avery, Judith A. Chevalier & Scott Schaefer, *Why Do Managers Undertake Acquisitions? An Analysis of Internal and External Rewards for Acquisitiveness*, 14 *J.L. ECON. & ORG.* 24, 24 (1998) (arguing that executives pursue prestige in the business community rather than extra compensation).

48. Sumantra Ghoshal, *Bad Management Theories Are Destroying Good Management Practices*, 4 *ACAD. MGMT. LEARNING & EDUC.* 75, 75 (2005) (citations omitted).

ing, and investment banking, which hire a substantial number of graduates from the premier schools of business.⁴⁹ For investors and consultants alike, their tasks involve diagnostics and analysis. So there is a tendency in both of these lines of work for practitioners to adopt a reductionist mindset, regarding the businesses under observation purely as independent, determined phenomena. In the ordinary curriculum of a business school, the primary components of analysis are products and services, cash flows, processes, brands, and other stylized ideas that have taken on their own metaphysical stature. The narrow, functionalist thinking that produced the orthodoxy surrounding the notion of agency, the restrictive view that value can only mean economic value to shareholders, and the myopic perspective that regards the purpose of the firm as shareholder-centered, all constitute the dominant narrative in business education.

George Anders explains Khurana's assessment of the situation as follows: "M.B.A. training has deteriorated into a race to steer students into high-paying finance and consulting jobs without caring about the graduates' broader roles in society." According to Khurana, the "logic of stewardship has disappeared" from business education. "Panoramic, long-term thinking," Anders contends, "has given way to an almost grotesque obsession with maximizing shareholder value over increasingly brief spans."⁵⁰

According to this received view of business management, what counts above all is "winning the war" against competitors and maximizing the bottom line. From this viewpoint, the idea of applying moral principles to business conduct is inconceivable, or as the cliché goes, business ethics is an oxymoron. Such a mental model rejects the notion that economic value is in any way related to moral conduct in business. Economics and morality are viewed as wholly dissimilar forms of discourse for managerial decision making and business practices. According to this view, the expectation that corporations exercise moral behavior beyond the requirements of law betrays a fundamental misconception about the nature of a free economy, unnecessarily imposes restraints on corporate activity, and squanders corporate

49. JOHN ROLFE & PETER TROOB, *MONKEY BUSINESS: SWINGING THROUGH THE WALL STREET JUNGLE* 8–9 (2000).

50. George Anders, *Business Schools Forgetting Missions?*, WALL ST. J., Sept. 26, 2007, at A2.

value on social initiatives of unsubstantiated value.⁵¹ The only plausible case for obeying legal and ethical standards, under this position, is to avoid the monetary cost of noncompliance.

Not only has business management theory been misdirected by positivist and scientist assumptions, it has also failed to provide any satisfactory understanding of what business actually is. For all of the technocratic blatherskite it generates, business theory gives little attention to the basic human interactions that make business a profoundly human enterprise.⁵² Yet business, in its most essential form, is a way that we create value for each other by cooperating and specializing our labor. Business is fundamentally about human relationships addressed to the proximate objectives of creating wealth and fostering trade, and to the broader objective of human fulfillment. In reality, business is utterly incapable of even occurring, much less flourishing, outside of interpersonal moral-social matrices. It is astounding that most theories of business—for instance, those premised upon shareholder theory—divorce business decisions from this human sphere.

The point is this: Not only have the mental models of economics and business management likely played a significant role in bringing about the financial crisis, but to the extent they neglect the moral and human dimensions of business, they are ill-equipped to provide any meaningful guidance for business leadership in the future. Providing such guidance will require a fundamental reframing of management practices to be more concordant with human nature and enduring moral values.

What is not ordinarily acknowledged is that classical economic theorists such as Adam Smith espoused principles that are in line with a robust pursuit of the common good in business. Barely one hundred years have passed since economic theory changed tracks and began developing an individualistic mindset grounded in the notion of scarcity and the view that people participate in the market purely as self-regarding profit-maximizers.⁵³

51. See MILTON FRIEDMAN, *CAPITALISM AND FREEDOM* 133–34 (1962).

52. See *BUSINESS AS A HUMANITY* (Thomas J. Donaldson & R. Edward Freeman eds., 1994).

53. Edward J. O'Boyle, *Person: An Economic Agent for the Electronic Age*, 34 INT'L J. SOC. ECON. 472, 478 (2007). Throughout the history of Western civilization, one repeatedly finds business ventures embodying humanitarian endeavors. Monasteries dating back to the Middle Ages were, in effect, incipient institutions of economic activity, in which *ora* (culture) and *labora* (work) were coupled. Likewise, as far back as the fifteenth century, the Franciscans had established the *Montes Pietati*

Notwithstanding this relatively recent transition in economic thought, three key ideas upon which a human focus and classical economic theory come into agreement are the concepts of virtue, human dignity, and public happiness or the common good. The term “public” underscores the reciprocal character of happiness, as opposed to affluence. That is, one can be affluent alone, but to be happy requires others.⁵⁴ Public happiness is diagnosed in a stream of economics literature stressing the concept that commodities and profits engender prosperity only when situated within a broader context of meaningful interpersonal relationships within which human dignity is accorded proper respect. Moreover, in the eyes of many classical economists, the market did not contravene civil society but was in fact the embodiment of it. Proper functioning of the market depended on contracts, cooperation, institutions, and trust. These in turn promoted reciprocity. Economic activity thus provided a setting where humans manifest their social being and reveal their desire for camaraderie in relationships of equality and civility.⁵⁵

Given contemporary technocratic understandings of the market, such characterizations no doubt appear strange, perhaps almost incomprehensible. Nevertheless, the crucial insight is this: The market reveals itself as a manifestation of social life when we can discern its strong dependence on the exercise of virtue, respect for dignity, and a shared sense of the common good. Logically, these moral elements must exist before bargaining. By building good and just institutions, and by forming agreements grounded in authentic trust rather than on the basis of deceptive

tis, precursors of modern banks, which grew up not directly seeking profit, but instead trying to battle usury and provide the impoverished with new beginnings in the wake of economic hardship. The nineteenth century also provided for a merging of economic and humanitarian objectives as the bulk of European welfare establishments and hospitals emerged out of spiritual associations. Luigino Bruni & Amelia J. Uelmen, *Religious Values and Corporate Decision Making: The Economy of Communion Project*, 11 *FORDHAM J. CORP. & FIN. L.* 645, 657–58 (2006).

54. A good deal of emerging research indicates that donors themselves experience a tremendous amount of benefit from giving. Indeed, economists and psychologists have found that charitable giving makes people healthier, happier, and even more financially successful. Giving is, in and of itself, a source of value for those who donate to charity. See ARTHUR C. BROOKS, *WHO REALLY CARES: THE SURPRISING TRUTH ABOUT COMPASSIONATE CONSERVATISM* (2006); STEPHEN POST & JILL NEIMARK, *WHY GOOD THINGS HAPPEN TO GOOD PEOPLE* (2007).

55. See SAMUEL GREGG, *THE COMMERCIAL SOCIETY: FOUNDATIONS AND CHALLENGES IN A GLOBAL AGE* 9 (2007).

and disingenuous transactions, market interactions can take on a wider and more virtuous role. This deeply human-centered conception of business is supported by a long tradition of thought common to ancient cultures.⁵⁶ That intellectual tradition emphasized the dependence of commercial life on human characteristics taken to be ennobling and immutable.

C. *Mental Model of Lawmakers and Legal Authorities*

A key limitation of this model inheres in the reality that the law ordinarily intervenes to supply enforceable norms where trust is lacking. Legal regulation, however, is no substitute for trust in business. The impotence of law to replace trust poses an especially acute problem in the context of the financial debacle, as it was precisely a retreat from trust that was one of the principal reasons for the near collapse of the world's financial markets. Credit, which constitutes the lifeblood of the world economy, had virtually dried up. Even large banking establishments were adverse to lending to one another; they simply did not trust that they were going to obtain repayment. Granted, legal structures assist in the enforcement of contracts, and contracts in turn facilitate the creation and enforcement of innumerable deals, agreements, and other business transactions. Nevertheless, one is not likely to sign a contract if there is no basis for trusting his counterparty. The existence of trust is vital for any business to forge solid relationships with key constituencies such as customers, employees, suppliers, and the wider social orders within which the business carries on its activities. Furthermore, trust impels the basic dynamic of taking risks, which serves to foster progress and innovation.

Not surprisingly, consistent with their disposition to approach all problems with increased regulation, many government agencies started contemplating new laws and regulations in response to the subprime housing and credit crisis as early as 2007. Thus, United States federal regulators started proposing new rules requiring mortgage lenders to peg loan decisions on borrowers' capability to repay adjustable rate mortgages at the full interest rate rather than on borrowers' ability to pay lower introductory

56. *See id.* at 3.

rates.⁵⁷ Moreover, industry trade journals began sending out smoke signals to their constituents announcing that new regulations would be a virtually certain consequence of the crisis.⁵⁸

Nevertheless, it is clear that such efforts at legal and regulatory intervention did not stop the crisis from unfolding. What the mindset of lawmakers and legal experts typically ignores is that a great deal of business activity cannot be effectively regulated, partly because it is normally too difficult or costly to do so and partly because legal regulation typically triggers ever more elaborate loophole-hunting avoidance schemes. Moreover, excessive regulation threatens to dilute, if not completely annihilate, entrepreneurial initiative.⁵⁹

One might turn to music as an analogy. The idea of perpetrating some mode of malfeasance on par with fraud while delivering a live violin performance is inconceivable. Without authentic technical and artistic mastery of the instrument there can be neither genuine musicianship nor decent music. Consider that for purposes of fostering musical artistry there are not, nor could there be, government regulatory agencies charged with such a mission. Imagine the absurdity of a law specifying how properly to deliver a trill, complete with a list of penalties for violations. Music is, in its essence, a self-regulating enterprise. A technical execution of all of the notes of a piece of music—call it “minimal compliance”—is understood by all reputable musicians to be merely the barest of requirements. Outstanding musicianship is all about the artistry that is added to the “minimal” accurate rendering of the notes. Just as integrity in music cannot be externally imposed, neither can in-

57. See, e.g., Vikas Bajaj, *Senate Questioning on Mortgages Put Regulators on the Defensive*, N.Y. TIMES, Mar. 23, 2007, at C4.

58. *Politically driven post-crisis legislation must be avoided*, BANKER, Apr. 7, 2008, http://www.thebanker.com/news/fullstory.php/aid/5663/Politically_driven_post-crisis_legislation_must_be_avoided.html.

59. For Michael Novak, the innovative spirit becomes the hallmark of capitalism. Criticizing Max Weber who holds “economic rationality” to be the essence of capitalism, and drawing from Hayek, Schumpeter, Kirzner, and others, Novak states that:

The heart of capitalism . . . lies in discovery, innovation, and invention. Its fundamental activity is insight into what needs to be done to provide a new good or service. The distinctive materials of capitalism are not numbers already assembled for calculation by the logic of the past. On the contrary, its distinctive materials are new possibilities glimpsed by surprise through enterprising imagination.

MICHAEL NOVAK, *THE CATHOLIC ETHIC AND THE SPIRIT OF CAPITALISM* 10 (1993).

tegrity in business be legislated. In both music and business, the exercise of virtue is fundamental, unavoidable, and part of the very lifeblood of the endeavor.

D. *Moral-Cultural Mental Model*

Beneath the all-too-real empirical crisis revealed by the mental models of economics, business, and law, there is a moral malaise that calls for a fresh mindset that can penetrate deeper and reach wider than these disciplines. To bring the distinctly moral dimension of the crisis into focus, consider the extent to which the subprime business market has been intimately bound up with a host of moral malfeasances. Moral failures leading to the financial crisis include:

- lenders enticing homebuyers into unsuitable mortgage arrangements;⁶⁰
- approximately seventy percent of homebuyers falsifying data on their mortgage applications;⁶¹
- financiers creating nontransparent financial products (securitized mortgages) with risks obscured in vague or utterly indecipherable legal terminology, if disclosed at all;⁶²
- rating agencies immersed in massive conflicts of interest issuing biased valuations of companies' financial postures;⁶³
- hedge funds intentionally circulating false information to "short" the shares of companies' stock ("predatory short selling");⁶⁴

60. Steven Malanga, *Whatever Happened to the Work Ethic?*, 19 CITY J. 36, 36–45 (2009). The existence of easy credit, along with the belief that home prices would keep on appreciating, persuaded legions of subprime borrowers to assume adjustable-rate mortgages. The financial institutions that offered these products lured homebuyers with below market interest rates for pre-established terms, followed by market interest rates for the rest of the mortgage's term. Unable to afford increased payments at the end of the initial grace period, many borrowers attempted to refinance. But refinancing proved difficult as housing prices started to drop across the United States. Borrowers found themselves incapable of avoiding heftier monthly payments by refinancing and started to default. Patrice Hill, *Treasury seeks to stem second wave of foreclosures*, WASH. TIMES, Feb. 13, 2008, at A1; Kathleen M. Howley, *Plummeting home values sinking American dream*, DETROIT FREE PRESS, Nov. 22, 2009, at 2.

61. Malanga, *supra* note 60, at 36–45.

62. See Khanna, *supra* note 22.

63. See *id.* (arguing that credit agencies failed in their role as "gatekeepers" to the financial system).

- corporations instituting compensation plans (“golden parachutes”) that rewarded executives for poor performance and for making decisions that contributed to the financial crisis by fueling excessive risk taking;⁶⁵
- hedge funds misleading investors by faking high performance.⁶⁶

We are thus barking up the wrong tree by looking to mathematized economics and positivist business management theory for enlightened understanding, and to stepped-up legal regulation for solutions. Given the moral dimensions of the crisis, where might we turn in the quest for a solution?

One answer might be to require business ethics courses in MBA programs. Regrettably, however, it is doubtful that the conventional business school ethics curriculum is capable of giving present and future business leaders the proficiencies they will need to navigate the dangerous currents flowing out of the current economic tumult.⁶⁷ Several serious defects in business

64. See Charles R. Schwab, *Restore the Uptick Rule, Restore Confidence*, WALL ST. J., Dec. 9, 2008, at A17 (describing the harm caused by “manipulative short sellers”).

65. Press Release, U.S. Dep’t of the Treasury, Statement by Treasury Secretary Timothy Geithner on Compensation (June 10, 2009), available at <http://www.treas.gov/press/releases/tg163.htm>.

66. A recent study found that it is “quite easy for a hedge fund manager to ‘fake’ high performance over an extended period of time without getting caught.” Dean P. Foster & H. Peyton Young, *Hedge Fund Wizards*, ECONOMISTS’ VOICE, Feb. 2008, at 1, 1. Hedge fund managers sometimes make risky speculative moves by investing in transactions that may yield higher-than-average returns because of the minute yet real risk that the whole venture may blow up. *Id.* This kind of arrangement, dubbed a “Taleb distribution,” has a strong likelihood of producing moderate gains and only a slight chance of resulting in huge losses in a given period. Martin Wolf, *Why today’s hedge fund industry may not survive*, FIN. TIMES, Mar. 19, 2008, at 15. Thus, even if the probability of suffering a large loss is one in ten, the fund manager might stand ready to assume the risk because, after all, his own money is not on the line, and he is likely to pull down a tidy profit for years to come. For instance, although the manager will likely be ousted should that one-chance-in-ten risk occur, the investment might nevertheless produce sufficiently large returns for the fund manager to get large returns, reap a “2 and 20” commission, and satisfy his clients along the way. To his clients, the fund manager will seem to have immense talent. The problem is that his clients have no way of suspecting that the manager is basically gambling their money away. See Thomas Donaldson, *Hedge Fund Ethics*, 18 BUS. ETHICS Q. 405, 409 (2008).

67. In a recent editorial Professor Michael Jacobs describes how failures related to board oversight, executive rewards, and agency costs, which contributed to the financial meltdown, were not even on the radar screens of America’s business schools. In his words, “[m]ost B-schools paper over the topic [of corporate governance] by requiring first-year students to take a compulsory ethics class, which

education cripple the ability of a large number of business schools to come to terms with business's moral sphere. One defect is their tacit encouragement of the attitude that if something is not illegal then it must be acceptable.⁶⁸ Another defect is their retreat from any rigorous engagement of matters of right and wrong. Their reason for shirking from such matters is the threat that a careful study of right and wrong poses to the strong moral relativism that pervades so many cultures and societies around the world today.⁶⁹ Consequently, business education mistakes the idea of morality to be coextensive with, on the one hand, a program of ethics "window dressing," and on the other hand, a program of "corporate social responsibility."

Under the "window dressing" approach, efforts to inculcate authentic moral sensitivity in future business leaders get sidetracked into image-conscious marketing strategies.⁷⁰ Armed with such strategies, MBA graduates, once absorbed into the corporate culture for which their business education has prepared them, perfect the art of crafting pious declarations of rectitude and peppering them throughout the annual reports, codes of conduct, and mission statements of business organizations. In the aftermath of the financial crisis, we have learned that many of these same institutions have been culpable for unprecedented levels of fraud and other forms of misconduct.⁷¹

is necessary, but not sufficient." Michael Jacobs, *How Business Schools Have Failed Business*, WALL ST. J., Apr. 24, 2009, at A13. Jacobs continues his critique by posing two rhetorical questions: "Would Bernie Madoff have acted differently if he had aced his ethics final? Could we have avoided most of the economic problems we now face if we had a generation of business leaders who were trained in designing compensation systems that promote long-term value?" *Id.*

68. For a detailed explanation of why the attitude "if it's legal, then it's morally okay" is insufficient, particularly in the intensively regulated field of finance, see BOATRIGT, *supra* note 45, at 9–10.

69. There is probably no better exposition of the moral relativism that pervades our age than the one given by Alasdair MacIntyre. He shows how contemporary moral fragmentation, in the form of emotivist and utilitarian culture, is connected to the loss of Aristotelian ethics together with the inability of the Enlightenment to supply any suitable substitution for it. See ALASDAIR MACINTYRE, *AFTER VIRTUE: A STUDY IN MORAL THEORY* 22–59 (1981).

70. See, e.g., Joe W. (Chip) Pitts III, *Corporate Social Responsibility: Current Status and Future Evolution*, 6 RUTGERS J.L. & PUB. POL'Y 334, 374 (2009).

71. Enron's mission statement listed the following values: respect, integrity, communication, and excellence. In addition, it proclaimed that all business dealings were to be "open and fair." Chris Penttila, *Missed Mission: Watch Out! If your mission statement is a joke, Enron may be the punchline*, ENTREPRENEUR, May 2002, at 73, 73. Almost all Fortune 500 companies have a mission statement. Within the

Under the “corporate social responsibility” approach, the province of “business ethics” gets denigrated to harum-scarum stratagems formulated as reactions to alarms sounded by “stakeholders” that are in turn dictated by galleries of activists purporting to be their appointed representatives. This variety of business ethics is mainly bent on promoting politically-correct agendas. The list goes on and on: Sustainability and environmental propriety, multiculturalism, diversity, and a host of similar agenda-based directives establish the criteria for a “good company.”⁷² Moreover, these criteria are placed under strict accountability, compliance, and enforcement demands in utter disregard of the type and character of the business at hand and the conditions under which it might prosper. This mindset concerning the nature of business ethics engenders the technocratic mental model of the lawmaker and legal expert discussed earlier. Those who espouse this mindset instinctively turn to government to concoct increasingly detailed regulations and to impanel officious bureaucrats (who are typically clueless about—if not downright antagonistic to—the world of business) to go about putting such regulations into effect.⁷³

It is reasonable to look to business education to provide professional guidance and intellectual leadership for a post-crisis moral-cultural mental model. Rather than relying on the run-of-the-mill “business ethics” approach, however, moving out of the crisis calls for a reckoning with enlightened philosophical concepts. Our thinking must be guided with timeless ideas like trust, honor, dignity, virtue, and the common good, wrought from ancient heritage. Yet equally importantly, we need to see clearly the demands that moral wisdom anchored in the past imposes upon us today.

At this point the moral relativist is likely to object, questioning the fundamental premise of the moral-cultural model,

text of nearly every mission statement there appears some statement of the firm’s commitment to moral values. Yet it is evident that legions of senior executives behave contrary to such pronouncements. For discussion of how misalignment of formal and informal messages sent out by firms to their employees poses challenges for developing ethical corporate culture, see LINDA KLEBE TREVIÑO & KATHERINE A. NELSON, *MANAGING BUSINESS ETHICS* (4th ed. 2007).

72. See Edwin M. Epstein, *The Good Company: Rhetoric or Reality? Corporate Social Responsibility and Business Ethics Redux*, 44 AM. BUS. L.J. 207, 212–14 (2007).

73. For a more detailed look at such tendencies to over-regulate the business world, see CATHERINE CRIER, *THE CASE AGAINST LAWYERS* (2002); PHILIP K. HOWARD, *THE DEATH OF COMMON SENSE: HOW LAW IS SUFFOCATING AMERICA* (1994).

namely, that the concepts of right and wrong are objective realities. Granted, there is no universally persuasive argument for the objectivity of moral standards. Nevertheless, the absence of a knock-down argument does not imply that the notion of an objective moral order is just a matter of parochial social construction, as the post-modernists, deconstructionists, and ethical relativists claim. If, however, enough people in our society and around the world are unable to identify something objectively wrong with the culture of business scandal that is beneath the financial collapse, the result will be to encourage behaving as if there are no moral standards in business at all.

It is now appropriate to discuss the three pillars of ethical thought that provide a foundation for a new moral vision in today's subprime mortgage market: virtue, human dignity, and the common good. These ethical concepts invoke the language of the natural law tradition. That venerable tradition offers an alternative to the reigning vision of economic life, which has brought many institutions and investors to ruin.

1. *Moral Virtue*

In the *Nicomachean Ethics*,⁷⁴ Aristotle grounds his moral philosophy on a number of basic propositions. To start with, Aristotle holds that possessing the capability for reason constitutes the essence of what it means to be human, with abstraction and moral reasoning comprising the uppermost modes of thinking.⁷⁵ This capacity includes the ability to decide among ethical and unethical means of living one's life and of arranging human enterprises. Accordingly, individual moral virtue arises from cultivating one's faculty of reason. In other words, we complete our humanity through cultivating our naturally given aptitude for rationality. All human beings thus possess the capability to learn and develop. The good life consists of being engaged in a process of fulfilling one's capacities—not in the attainment of complete fulfillment, which is impossible. Although improving on a person's natural capabilities constitutes the *summum bonum*, it does not comprise the "complete good." One does not develop oneself

74. ARISTOTLE, *THE NICOMACHEAN ETHICS* (Hugh Tredennick ed., J.A.K. Thomson trans., Penguin Books 2004).

75. *Id.* at 15–16.

for narrow self-centered purposes, but rather to add to the good of the community to which one belongs.

Human happiness, for Aristotle, arises from having chosen virtuous actions.⁷⁶ A virtuous action falls within the “golden mean,” which rests midway between two vices that make up the extreme endpoints of any character trait: deficiency and excess.⁷⁷ For example, Aristotle states that people should be generous, meaning that they should neither be too wasteful nor parsimonious.⁷⁸ They ought to be temperate. As such they will prevent having their lives dictated by irrational appetites like envy and lustfulness. Happiness demands that they remain even-tempered. Of course, they may exhibit some measure of anger when the occasion warrants, yet they will eschew irascibility or wrath. They should take appropriate pride in their attainments without being boastful. Aristotle thinks the golden mean can be struck for other character traits as well.⁷⁹

Some contend that certain types of executive compensation arrangements have contributed to the financial collapse. The arrangements are supposed to have offered inducements to cheat, perpetrate fraud, and cook the books to fabricate levels of reported corporate performance so as to elicit exorbitant payoffs. That is, they would reward businesspeople for immoral practices.⁸⁰ Accordingly, such executive compensation plans are squarely counter-Aristotelian and contrary to virtue ethics. Executive compensation plans that motivate managers to manipulate performance levels rather than to build genuine value for their firms fail to promote virtue; instead they encourage and reward vice, namely the character deficiency of “acquisitive ungenerosity,” which for Aristotle amounts to the dishonorable worship of profit.⁸¹

76. *Id.* at 267–71.

77. *Id.* at 42.

78. *Id.* at 43–44.

79. *Id.* at 43–46.

80. See Jared D. Harris & Philip Bromiley, *Incentives to Cheat: The Influence of Executive Compensation and Firm Performance on Financial Misrepresentation*, 18 *ORG. SCI.* 350 (2007); Jared D. Harris, *What’s Wrong With Executive Compensation?*, 85 *J. BUS. ETHICS* 147 (2009).

81. Aristotle notes that this trait can be found in a certain class of people:

[Some] go to excess in receiving by taking anything from anybody; for instance, those who follow illiberal occupations, like ponces and all people of that kind; and moneylenders who make small loans at a high rate of interest; for all these receive more than is right, and not from the right sources. Their common characteristic is obviously their sordid

2. Human Dignity

The idea of human dignity encompasses the intrinsic worth inherent in all human beings. From the natural law perspective, and in the eyes of Catholic social thought, the source of human dignity is the concept of *imago Dei*, which conceives of the human person as having been created in the image and likeness of God.⁸² Human dignity surpasses any particular social order as the foundation for moral rights, and can neither be bestowed nor legitimately infringed by society. As such, human dignity forms the conceptual core of human rights. Within the tradition of Catholic moral thinking, insofar as there is a communal or social aspect to human dignity, persons ought not to be regarded in excessively individualistic terms. Rather, persons should be considered as essentially connected to the rest of society.

Immanuel Kant states that it is morally impermissible to treat people merely as a means rather than as an end.⁸³ That is to say, it is wrong to treat a human being simply as if he were an instrument, tool, or object. This aspect of Kant's philosophy encourages us to reflect on our reaction to treatment received in situations of indignity where we may have exclaimed "Hey, you've been *using* me!" Kant's thinking also helps us to envision

avarice, because they all put up with a bad reputation for the sake of gain—and a small gain at that. I say this because we do not call illiberal those who wrongly take large sums from wrong sources, e.g. despots who sack cities and plunder temples—they are more properly called wicked and impious and unjust. But the cardsharp and the clothes-stealer belong to the illiberal class, because they are sordidly avaricious: it is for gain that both types follow their profession and submit to a bad reputation, the one accepting the severest risks for the sake of their pilferings, the other profiting at the expense of their friends, to whom they ought to give; so both are sordidly avaricious, because they want to make gain from a wrong source. All such ways of obtaining money are illiberal.

ARISTOTLE, *supra* note 74, at 88 (section numbers and internal markings omitted).

82. CATECHISM OF THE CATHOLIC CHURCH ¶¶ 355–384; SECOND VATICAN ECUMENICAL COUNCIL, DECLARATION ON RELIGIOUS FREEDOM, *Dignitatis Humanae* ¶¶ 2, 9 (Dec. 7, 1965); SECOND VATICAN ECUMENICAL COUNCIL, PASTORAL CONSTITUTION ON THE CHURCH IN THE MODERN WORLD, *Gaudium et Spes* ¶¶ 12–24 (Dec. 7, 1965) [hereinafter *Gaudium et Spes*]; SECOND VATICAN ECUMENICAL COUNCIL, DECLARATION ON THE RELATIONSHIP OF THE CHURCH TO NONCHRISTIAN RELIGIONS, *Nostra Aetate* (Oct. 28, 1965); Pope Pius XII, Encyclical Letter, *Humani Generis* (Aug. 12, 1950); Pope John Paul II, Encyclical Letter, *Redemptor Hominis* (Mar. 4, 1979); Pope John Paul II, Encyclical Letter, *Veritatis Splendor* (Aug. 6, 1993). All referenced documents are available on the Vatican website.

83. IMMANUEL KANT, THE MORAL LAW: KANT'S GROUNDWORK OF THE METAPHYSIC OF MORALS 95–96 (H.J. Paton trans., 1961) (1785).

what it means to treat people in morally permissible ways—that is, as ends in themselves, dignified beings worthy of respect.

Many of the kinds of unethical business conduct that have rendered the financial crisis a serious moral scandal fail to respect human dignity, in the sense that such behavior infringes upon the moral rights of others. For example, consider the practice of predatory lending, which involves entering into unsound secured loans for inappropriate purposes. Countrywide Financial Corporation used a bait-and-switch technique, advertising low interest rates for home refinancing.⁸⁴ Loans were written into extensively detailed contracts, and then swapped for more expensive loan products at closing. An advertisement might show that 1% or 1.5% interest would be charged. Then, a consumer is placed into an adjustable rate mortgage (ARM), allowing homeowners to make interest-only payments, yet the interest charged is more than the amount of interest paid. This mismatch creates negative amortization, which the homeowner might not notice until long after the loan transaction has been consummated. It is clear that business practices such as predatory lending treat people merely as means to an end. Businesspeople flout principles of human dignity whenever they deceive, manipulate, or otherwise treat individuals as if they were not worthy of moral respect.

Rabbi David Novak stresses, in his reflections on the threat to human dignity that sundry improprieties associated with the financial crisis represent, the need for cultivating a greater awareness of moral conscience in business culture. According to Novak:

What is new is not what these [corporate] thieves have done, or even how they have done it. What is new is the political culture that has deprived them of the capacity for any real agony before they steal, or the capacity for any real remorse after they have stolen, even after they have been caught. What is new is the political culture that has deprived too many of us, who are not thieves, of the capacity to demand any real regret from those who are thieves, because we have lost the capacity to judge thievery with any real opprobrium.

....

The key . . . is to distinguish a political culture that cogently encourages one to be ashamed of wrongdoing, and a political

84. Mark Brown, *Countrywide Wasn't Really on Your Side; Mortgage Crisis Comes Down to Plain Old Consumer Fraud*, CHI. SUN TIMES, June 26, 2008, at 8.

culture that only pragmatically judges the good or bad consequences resulting from the exercise of one's self-interest or actually approves of what one has done. That kind of culture only pities the criminal for his or her bad luck in getting caught, and especially for having to "do hard time" in prison.⁸⁵

3. *The Common Good*

How should we understand the concept of the common good? Certainly, we can associate a variety of meanings with the term.⁸⁶ For purposes of the present discussion, the common good is more than the competing interests of selfish individuals and more than the composite interests of special groups. It is the good we have in common—the communal conditions necessary for the virtuous pursuit of human fulfillment, flourishing, and perfection by all in society.⁸⁷ Ultimately, the common good is the aggregation of collaborative initiatives and shared restraints by which society helps everyone achieve what in the end only each individual can accomplish for himself: shaping a good will and constituting an authentically human self by freely choosing to actualize the good every time one is given the chance and responsibility to do so.⁸⁸ In addition to its tendency to reward unscrupulous conduct, the executive compensation schemes connected to the financial crisis are inimical to the common good in that they provide powerful incentives to people to maximize their selfish interests at the expense of the wellbeing of persons throughout society.

The moral degradation leading to the financial crisis reminds us of our interdependence and summons us to mutual responsibilities. Catholic thought provides a rich resource for embarking upon just such a path. Consider John Paul II's encyclical *Centesimus Annus*:

85. David Novak, *Natural Law, Human Dignity, and the Protection of Human Property*, in PROFIT, PRUDENCE AND VIRTUE 42, 47, 51–52 (Samuel Gregg & James Stoner eds., 2009).

86. See MICHAEL NOVAK, FREE PERSONS AND THE COMMON GOOD 175–88 (1989).

87. Vatican II defined the common good similarly as "the sum of those conditions of the social life whereby men, families and associations more adequately and readily may attain their own perfection." *Gaudium et Spes*, *supra* note 82, ¶ 74.

88. I have elsewhere provided an analysis of how such a notion of authenticity and self-actualization applies to a variety of the moral dilemmas one confronts in the world of business, drawing upon the existentialist philosophy of Jean-Paul Sartre. See Kevin T. Jackson, *Towards Authenticity: Taking a Sartrean Perspective on Business Ethics*, 58 J. BUS. ETHICS 307 (2005).

[W]e see how [*Rerum Novarum*] points essentially to the socioeconomic consequences of an error which has even greater implications. As has been mentioned, this error consists in an understanding of human freedom which detaches it from obedience to the truth, and consequently from the duty to respect the rights of others. The essence of freedom then becomes self-love carried to the point of contempt for God and neighbor, a self-love which leads to an unbridled affirmation of self-interest and which refuses to be limited by any demand of justice.⁸⁹

For a reframing of our mental model to occur in the aftermath of the financial scandal, we must return to the ethics of virtue, human dignity, and the philosophy of the common good. Here is where human freedom and individual interest reach their proper proportion.⁹⁰

III. MORAL-CULTURAL DYSFUNCTIONS INDICATED BY THE CRISIS THAT ARE NOT TREATABLE BY LEGAL REGULATION

A. *Post-Modernism*

What are the moral-cultural roots of the economic crisis? Could it be that, as historian Harold James has suggested, under the influence of postmodernism within the broader culture, what has emerged is a greater eagerness to take irrational risks and to supplant reason with subjective feeling and intuition? Has such a trend in turn fostered a willingness, for instance, to provide and accept valuations of complex and basically incomprehensible securities?⁹¹

To posit the existence of linkages between postmodern culture and financial decrepitude may not be as implausible as it first appears. Recall the movie *Wall Street*.⁹² Oliver Stone's masterful portrayal of a postmodern abandonment of reality through the character of Gordon Gekko depicts a financial

89. Pope John Paul II, Encyclical Letter, *Centesimus Annus* ¶ 17 (May 1, 1991).

90. The reference to "proper proportion" refers us back to Aristotle's idea of virtue as a mean between extremes. ARISTOTLE, *supra* note 74, at 39–42.

91. See Harold James, Op-Ed., *A Financial Crisis Letting Us Unmask Deceit; But Whose Deceit?*, DAILY STAR (Lebanon), June 8, 2009, http://www.dailystar.com/lb/article.asp?edition_ID=10&article_ID=102752&categ_ID=5.

92. WALL STREET (20th Century Fox 1987).

world that has become as ephemeral as streaming real-time stock quotes. Thus, in one of Gekko's memorable lines, he intones that "money itself isn't lost or made, it's simply transferred from one perception to another." In a scene with his ex-lover, Darien, (immediately following his purchase of obscenely overpriced abstract expressionist artwork in an auction) Gekko announces: "We are smart enough not to buy into the oldest myth running: love. A fiction created by people to keep them from jumping out of windows." And in a soliloquy to his protégé, Bud Fox, Gekko cynically proclaims:

The richest one percent of this country owns half the country's wealth: 5 trillion dollars. One third of that comes from hard work, two thirds of it comes from inheritance, interest on interest accumulation to widows and idiot sons and what I do—stock and real estate speculation. It's bullshit. Ninety percent of the American people have little or no net worth. I create nothing: I own. We make the rules, buddy, the news, war, peace, famine, upheaval; the cost of a paper clip. We pull the rabbit out of the hat while everybody else sits around their whole life wondering how we did it.

Looking back at the various forms of financial innovation and complexity that precipitated the economic crisis, one can see that the financial experts who appeared to be selling wealth-producing innovative ideas did so with the encouragement of a cultural climate that is enamored of excessive experimentation; prone to disrespect for discipline, authority, and hierarchy; and opposed to traditional values. The shocking result is that any kind of value—whether moral, aesthetic, or financial—is in danger of becoming regarded as arbitrary and fundamentally absurd.

It is important to point out that, in earlier times, mainstream education stressed these virtues. For instance, the study of musical harmony, undertaken within a framework of tonality, emphasized order and hierarchy. Similarly, in the study of syllogisms of logic, students were made aware of external authority and the demands of order and stability.⁹³ Contrast this tradition with today's violent rap music and trends in education, such as the "self-esteem" movement, which essentially serve to cultivate indiscip-

93. See Robert H. Bork, *Thomas More for Our Season*, *FIRST THINGS*, June/July 1999, at 17, 17.

line.⁹⁴ Is it any wonder that signs of disorder and systemic crisis eventually appeared in the sphere of finance and business?

B. *Rise in Speculative Culture*

In finance, the concept of a speculative bubble can be explained roughly as follows. First, a quick yet normally short-lived run-up in prices comes about, not as a result of basic underlying market fundamentals, but rather from irrational exuberance. Then, while the speculative bubble grows, increasing numbers of investors are prone to buy, until it starts to look as if “everyone” thinks that prices are going to move yet higher. Finally, when the bubble eventually bursts, prices drop even more quickly than they ascended, with everybody clamoring to sell at once. Such panic selling in turn triggers widespread and acute losses.

To think about how the speculative bubbles underlying the recent financial crisis are connected to the rise of “speculative culture,” it is helpful to go back to the work of Thorstein Veblen. Writing at the beginning of the twentieth century, Veblen offered a nuanced distinction between entrepreneurs and speculators: The entrepreneur is a businessman with a project who calculates the success of his business according to its realization of that project. To the entrepreneur, however, profit represents only one gauge of the goodness of the activity, not the end-all-and-be-all.⁹⁵ A speculator, on the other hand, pursues a particular project with the sole objective of making money. Whatever the material object of the activity happens to be is inconsequential. Indeed, a speculator will switch ventures or change to a different economic sector the moment he finds a more profitable pathway to generate money.⁹⁶

An illustration of the peculiar fascination with—indeed outright glorification of—speculative pursuits in our culture can be seen in bestselling books such as Victor Niederhoffer’s *The Education of a Speculator*, in which representations of stock charts are absurdly juxtaposed with the musical manuscripts of such timeless masters as Ludwig von Beethoven and Alexander Scriabin.⁹⁷ It is

94. *See id.* at 17–18.

95. *See* THORSTEIN VEBLÉN, *THE THEORY OF BUSINESS ENTERPRISE* 41–42 (1904).

96. *See id.* at 27–29 (comparing a businessman whose “end is pecuniary gain” to a “speculator in grain futures”).

97. VICTOR NIEDERHOFFER, *THE EDUCATION OF A SPECULATOR* 327–34 (1997).

interesting to note that, on its back cover, the book's promotional blurb proudly recites the paradox that its author is "a contrarian trader" who attained "staggering wins and stellar performance" yet "was forced to close his fund due to heavy losses."⁹⁸

Turning to the economic crisis, examples abound of unsound business practices fueled by a speculative economic culture. For instance, consider "flipping."⁹⁹ In the case of house flipping, a speculator might buy a house for \$300,000 in February. The speculator's intention is not to live in the house or even to rent it out for others to live in, but rather to turn around and sell it for \$400,000 as early as July and pocket the profits. Flipping has become so popular in the United States that some do-it-yourself television programs, such as A&E's "Flip This House," portray the method in detail.

Another example of speculative culture is the prevalence of so-called "NINJA" loans, a variety of subprime loans issued to borrowers with "No Income, No Job and No Assets."¹⁰⁰ They were especially prominent during the subprime mortgage crisis, serving as an example of poor lending practices. The term grew in usage as the subprime mortgage crisis came to be blamed on such loans.

C. *Egoistic Individualism*

It is a symptom of our disorder that a sizable segment of today's culture is inclined toward the glorification of the self, a trend that is based on the philosophy of egoistic individualism. This philosophy embraces the belief

that the individual exists solely for her own happiness and thus that rational self-interest is the only objective basis for moral action. There are no moral constraints on the selfish pursuit of personal happiness, except force and fraud. And there is no moral duty to sacrifice individual advantage for

98. *Id.* at Back Cover.

99. In general, "flipping" refers to the practice of buying an asset and quickly reselling it for profit. Although flipping can apply to any asset, the term most often refers to real estate and initial public offerings.

100. The phrase was coined by HCL Finance to designate one of its financial products. Edward Chancellor, *Ponzi Nation*, INSTITUTIONAL INVESTOR, Feb. 2007, at 56. The phrase is a play on words on two levels: first, as an acronym; second, as a signal that NINJA loans frequently end up in default, with the borrower vanishing into thin air like a ninja.

any greater good, because there simply is no greater good than personal happiness¹⁰¹

Such an outlook goes hand-in-hand with two of the chief tendencies toward which contemporary business education is inclined: subjective moral relativism (emotivism) and the assumption that if something is not illegal, it must be okay.

According to the storyline of this philosophy in the context of business, “corporate executives . . . seek what [is] best for the institution and its investors—and . . . self-interest . . . align[s] private profit with institutional good.”¹⁰² Market participants pursue their respective individual “advantage[s] regardless of others, because individual happiness is the ultimate good.”¹⁰³ Consider how this ideal works in the context of executive compensation. In many instances the compensation packages of high-ranking executives provide lavish remuneration irrespective of the firm’s stock performance. As in the collapse of Washington Mutual, Lehman Brothers, Bear Stearns, and others, top executives were able to escape with “golden parachutes” such as cash bonuses, severance pay, stock options, and other benefits.

The egoist ethos amplifies this divergence between private interest and common good throughout many sectors of the financial market. Consider the mortgage market. For the mortgage lender, issuing risky loans that are unlikely to be repaid is a good investment, as long as the secondary mortgage market allows him to pass the risk of default to others by selling mortgage-backed “securities.” Even if the borrower later goes into default, the mortgage lender has gained in the market so long as he is able to remove the loan from his books and reap his commission.

Furthermore, for the investment banker, purchasing bonds backed by risky loans is also a good investment, so long as a derivatives market allows him to “swap” the risk with a leveraged investor or an insurance company. Even if the underlying loans go into default, the investment banker has still maintained his market position, so long as his credit-default swaps pay out and he covers his losses.

101. Darrin W. Snyder Belousek, *Greenspan’s Folly: The Demise of the Cult of Self-Interest*, AMERICA, Mar. 30–Apr. 6, 2009, at 10, 10–12. Snyder Belousek is restating Ayn Rand’s philosophy of egoism as expressed in AYN RAND, *THE VIRTUE OF SELFISHNESS: A NEW CONCEPT OF EGOISM* (1964).

102. Snyder, *supra* note 101, at 12.

103. *Id.*

In short, so long as there is a market for betting on loan defaults and so long as there are investors willing to take the bets, financial risks that promise individual profit with potential cost to the common good make rational sense. Of course, this game of risk is sustainable only so long as the bets continue to pay off—which means in the case of the financial crisis, only so long as housing prices continued rising. With the burst of the bubble in the housing market, resulting in a flood of mortgage defaults, bond sellers and default insurers alike were left unable to make good on their promises, leaving bondholders to absorb the losses that they had gambled on others paying. Although the risk-takers have reaped their reward, stockholders and taxpayers have borne the real cost.

The proposals of those using the mental model of legal experts to expand regulation of capital markets and executive compensation to rein in self-interest do not get to the heart of the matter. The deeper philosophical issue is that the egoist ethic as such is an insufficient foundation for economic life. What the financial crisis teaches is that excessive self-interest is economically destructive. Unrestrained selfishness is a vice, undermining not only the general welfare but also self-interest.

The pursuit of rational selfishness untempered by moral constraint erodes the trust between financial institutions necessary to sustain the flow of credit upon which a market-capitalist economy depends. Insofar as buying into the market carries risk, it also necessitates trust. Trust in the market, however, can neither be purchased nor legislated into existence. Trust arises out of the trustworthiness of market participants, whether they be buyers or sellers, borrowers or lenders. Without mutual trustworthiness, opportunities for commercial interaction are constricted. In this sense, whether in the public square or the marketplace, moral virtue is at the heart of human liberty. What Benjamin Franklin wisely said about political liberty is therefore true of economic liberty as well: “[O]nly a virtuous people are capable of freedom.”¹⁰⁴

IV. SAFEGUARDING MARKET ECOLOGY

Since Aquinas, the natural law tradition has sought to use human reason to derive moral principles that promote human

104. Letter from Benjamin Franklin to Abbots Chalet & Arnaud (Apr. 17, 1787), in 11 *THE WORKS OF BENJAMIN FRANKLIN* 318 (John Bigelow ed., The Knickerbocker Press 1904).

wellbeing.¹⁰⁵ The moral urgency engendered by the present economic crisis ought to prompt a return to reason so as to discern moral principles that impose civic moral obligations on market participants from corporate leaders to behind-the-scenes “gatekeepers,” such as accounting and law firms, to avoid the infliction of systemic abuse upon—indeed, the outright sabotage of—the overall market system. Such duties of avoidance are important to achieve all market participants’ shared goal of overall economic welfare as a necessary, albeit not sufficient, condition for achieving human wellbeing. We might think of this as the “ecology” of market efficiency.

A. *Moral Coordination*

Maintaining market ecology demands moral coordination. The challenge of preserving the ecology of market efficiency is particularly relevant to the present problem of subprime business scandals, because it requires that market participants not, among other things, distort information that ought to be available to other market participants—that is, information upon which market efficiency itself depends. Turning to the ideas of Adam Smith and Friedrich Hayek will prove particularly instructive with respect to the concept of market ecology.

1. *Adam Smith*

For Adam Smith, individual choice and personal freedom drive free commerce and enlightened commercial society in general. They inspire an attitude of industry that brings about enhanced opportunities, leading vast portions of humanity to enjoy a more appealing and remarkable existence.

Across the expanses of a free capitalist economy, individuals—seeking betterment for themselves, their loved ones, and their communities—willingly contribute vigor, aptitude, and expertise. In the process—by the operation of an “invisible hand”—they are simultaneously improving the economy as a whole.¹⁰⁶ The strength of their initiative, and consequently the

105. See JOHN FINNIS, *AQUINAS: MORAL, POLITICAL, AND LEGAL THEORY* 266–74 (1998); JOHN FINNIS, *NATURAL LAW AND NATURAL RIGHTS* 281–90 (1980).

106. See ADAM SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* 456 (R.H. Campbell & Andrew S. Skinner eds., Oxford Clarendon Press 1976) (1776).

fruit of their productive efforts, will diminish if they sustain it only by force. Moral behavior is a prerequisite for the invisible hand to operate. Business activity is not possible without basic regard for ethical standards that respect property rights, honor promises, and ensure mutual commitments.

It does not follow, however, that the impulses responsible for enlivening the market are purely self-interested. Nor is the invisible hand simply a disinterested curative for greed and selfishness. Adam Smith argued that humans have a basic regard for others, or a sentiment of beneficence, in the absence of which the market would not function properly.¹⁰⁷ Economic activity thus flourishes among people only in the presence of moral sentiments, including norms of duty, integrity, and fairness.

Smith's portrayal of free market competition is best interpreted in association with his views on human motivation, as laid out in *The Theory of Moral Sentiments*.¹⁰⁸ Sympathy, benevolence, and the stance of the "impartial spectator"—part and parcel of our moral nature—continuously modulate the brute pursuit of profit. According to Smith, what appears from one perspective as self-gain is seen from another viewpoint as benevolence.¹⁰⁹ Indeed, the most profitable business strategy often involves sublimating short-term financial yield to long-term investments in honor, kindheartedness, or benefaction.

2. Friedrich Hayek

According to Hayek, social institutions such as money, credit structures, markets, and property represent "spontaneous orders."¹¹⁰ Hayek asserts that spontaneous orders are complex

107. For an extended analysis of Smith's argument for the necessity of beneficence to a well-functioning marketplace, see RYAN PATRICK HANLEY, *ADAM SMITH AND THE CHARACTER OF VIRTUE* (2009).

108. ADAM SMITH, *THE THEORY OF MORAL SENTIMENTS* (D.D. Raphael & A.L. Macfie eds., Oxford Univ. Press 1976) (1759).

109. *Id.* at 184–85 ("The rich . . . consume little more than the poor, and in spite of their natural selfishness and rapacity, though they mean only their own conveniency, though the sole end which they propose from the labours of all the thousands whom they employ, be the gratification of their own vain and insatiable desires, they divide with the poor the produce of all their improvements. They are led by an invisible hand to make nearly the same distribution of the necessaries of life, which would have been made, had the earth been divided into equal portions among all its inhabitants . . .").

110. F.A. HAYEK, *THE FATAL CONCEIT: THE ERRORS OF SOCIALISM* 102 (W.W. Bartley III ed., Univ. of Chi. Press 1988).

and abstract, and depend on general rules. In his words, “[t]he insight that general rules must prevail for spontaneity to flourish, as reaped by Hume and Kant, has never been refuted, merely neglected or forgotten.”¹¹¹

Although spontaneous orders are governed by general rules of conduct (which in turn are under the influence of human choice in various times and places), they depend mainly on self-generating characteristics resting at the center of market activity. Individual freedom and personal choice make up the heart of the market economy. For Hayek, a well-working market economy cannot be a constructed order, because the market is much too complicated to be designed by humans. Instead, the market is the byproduct of countless human interactions over time.¹¹²

For Hayek, “we are able to bring about an ordering of the unknown *only by causing it to order itself*.”¹¹³ Failure to recognize the difference between constructed orders and spontaneous orders amounts to the “fatal conceit,” which breeds social engineering that restricts individual freedom and erodes market economies. The result of treating spontaneous orders such as the market as if they were merely constructed orders formed by human design is to advance on a path toward totalitarian serfdom.¹¹⁴

Conducting business freely belongs to the realm of spontaneous ordering that draws upon self-generating features. Stressing the fundamental difference between spontaneous ordering and artificial ordering is fundamental in Hayek’s thought. His writings continually stress the supremacy of the former over the latter, claiming that it is next to impossible to make spontaneous order better by supplanting it with artificial varieties. Indeed, trying to “fix” apparent problems in spontaneous orders just ends up making things worse:

Most defects and inefficiencies of such spontaneous orders result from attempting to interfere with or to prevent their

111. *Id.* at 73.

112. *See id.* at 84.

113. *Id.* at 83.

114. *Id.* at 7 (“The main point of my argument is . . . that the conflict between, on one hand, advocates of the spontaneous extended human order created by a competitive market, and on the other hand those who demand a deliberate arrangement of human interaction by central authority based on collective command over available resources is due to a factual error by the latter about how knowledge of these resources is and can be generated and utilised.”); *see also* HAYEK, *supra* note 2.

mechanisms from operating, or to improve the details of their results. Such attempts to intervene in spontaneous order rarely result in anything closely corresponding to men's wishes, since these orders are determined by more particular facts than any such intervening agency can know. Yet, while deliberate intervention to, say, flatten out inequalities in the interest of a random member of the order risks damaging the working of the whole, the self-ordering process will secure for any random member of such a group a better chance over a wider range of opportunities available to all than any rival system could offer.¹¹⁵

The natural law tradition supplies a theoretical basis for Hayek's preference for the classical liberal ideal of limited government and strong confidence in competitive markets for the production and distribution of goods and services. Hayek deemed the free-enterprise economy to be a spontaneous order, and any substitute for it, like socialism, to be artificial. As such, the ascendancy of the free market over planned economies follows a fortiori from the preeminence of spontaneous order over artificial alternatives to it.

Applying Hayek's insights to the ecology of the modern market, it is evident that today's financial institutions are not isolated entities. Instead, they are thoroughly enmeshed in a web of property rights and innumerable day-by-day dealings, conventions, and traditions, including reputation and trust.

Pulling together the conceptual threads that have been spun, private property, private initiative, private risk, and private profit are all essential attributes of the capitalist system. These things, however, are economically effective only against a background of norms and values in which profit may certainly be kept in view, but seldom is the only goal at which business activity aims.

Francis Fukuyama has shown that populations possessing a culture of integrity and trust will succeed in generating material wealth and prosperity despite being situated under unfavorable conditions.¹¹⁶ In this regard, a society that has succeeded in amassing pools of social capital, such as that of the United States, not just through law and regulation, but also through the development of a broader culture, social networks,

115. HAYEK, *supra* note 110, at 84–85.

116. See FRANCIS FUKUYAMA, *TRUST: THE SOCIAL VIRTUES AND THE CREATION OF PROSPERITY* (1995).

and a wide array of private institutions, is going to be ahead of the curve in its ability to emerge from economic devastation.

Furthermore, it is reasonable to suppose that human nature leads us to build up, in addition to reputational and social capital, more tangible assets such as health care, food, housing, income, and so on. We regard an increase in such resources as good even before considering how the increase will be passed around to everyone.

Other things being equal, achieving more efficiency means having greater aggregate resources, in both tangible and intangible forms. Yet because regulatory regimes are unable to legislate and enforce all of the moral conduct necessary for optimal efficiency, market participants, in their pursuit of profit, have basic civic responsibilities to support cooperative business practices that enhance the overall efficiency of the market. What does this duty mean in the specific context of the current financial debacle? Market participants ought to:

- promote transparency of relevant information (for example, disclose the value of mortgage-related securities and other investments);
- refrain from abusing business-government relationships (for example, creating a dependency on, and expectation of, government bailouts);
- honor contracts, promises, and other commitments;
- avoid crony capitalism;
- avoid fraud;
- avoid insider trading;
- develop compensation programs that are fair and reasonable and reward executives for forthright conduct, not for indulging in vice.

Business leaders must develop virtues of cooperative action that will foster market efficiency, not burn it down. Based on views such as those of Smith and Hayek, it is clear that the task of cultivating such economic virtues penetrates far beyond the reach of legal regulation. Moral coordination, as a response to the rash of scandals, promises to circumvent the drawbacks of overt regulation and will be a step in the direction of building trust from Wall Street to Main Street.

B. No Bailout for Loss of Reputational and Social Capital

The preservation of overall market efficiency requires much more than market freedom and government regulation—it requires trust, transparency, and truth. In principle, governments possess the authority to enforce business agreements. Yet official efforts to provide legal insulation from all contractual breaches would be utterly futile were it not for a thick blanket of shared moral standards of promise-keeping and honor. Moral standards are essential for facilitating efficient economic activity. In a free market, these moral standards are properly “enforced” against individuals and firms alike, not primarily or exclusively with government regulation, but rather with reputational standards established by members of a free society.¹¹⁷ Recent studies show that a majority of people believe businesses ought to be held to the same or even higher moral and ethical standards as individuals.¹¹⁸ Moreover, a sizable percentage think we ought to hold companies to even more stringent standards than those to which we hold people, because businesses’ size, resources, knowledge, and impact greatly exceed those of individuals.¹¹⁹

One important lesson from the crisis is that a deep connection exists between economic value and moral virtue. The physical and financial assets that market participants work so hard to establish on their books are fundamentally linked to the way they deploy—or destroy—intangible reputational assets such as credibility and transparency. Such intangible assets, which represent the most powerful force behind a firm’s long-term performance, are vanishing from our financial system virtually unnoticed. Thus, all of the effort to tally up the staggering financial losses from the collapse of Lehman and other financial institutions ignored a much greater and more significant loss of wealth from the raft of financial scandals: the catastrophic exodus of reputational and social capital from financial institutions and from corporate and political leaders. Indeed, even the reputation of capitalism itself has been sullied as a consequence of financial malfeasance.

117. See Kevin T. Jackson, *Global Corporate Governance: Soft Law and Reputational Accountability*, 35 *BROOK. J. INT’L L.* 41 (2010).

118. See, e.g., VALERIE P. HANS, *BUSINESS ON TRIAL: THE CIVIL JURY AND CORPORATE RESPONSIBILITY* 120–21 (2000).

119. See LYNN SHARP PAINE, *VALUE SHIFT: WHY COMPANIES MUST MERGE SOCIAL AND FINANCIAL IMPERATIVES TO ACHIEVE SUPERIOR PERFORMANCE* 112 (2003).

Both reputational capital¹²⁰ and social capital¹²¹ constitute valuable forms of intangible wealth. Any business typically is involved in either creating or depleting them in their day-to-day activities. When tallying up the assets of a business enterprise one should include trust, good will, respect, fellowship, and sympathy among its stakeholders, as well as social networks that will serve to implant the enterprise within the field of moral sentiments of its constituencies. Among the valuable contributions of emerging theories of social capital and reputational capital are their explanation for why running a successful business does not necessarily require the kind of relentless pursuit of profit that is emblematic of the shareholder-centric theories of business.¹²² What it takes to build the reputational capital of a business—perhaps its most valuable capital asset—comes about from working towards things that are not readily

120. The concept of reputational capital refers to the intangible long-term strategic assets of a businessman or a business organization. Reputational capital is a hybrid of economic values and moral values. See RONALD J. ALSOP, *THE 18 IMMUTABLE LAWS OF CORPORATE REPUTATION: CREATING, PROTECTING, AND REPAIRING YOUR MOST VALUABLE ASSET* (2004); GRAHAME DOWLING, *CREATING CORPORATE REPUTATIONS: IDENTITY, IMAGE, AND PERFORMANCE* (2001); CHARLES J. FOMBRUN & CEES B.M. VAN RIEL, *FAME & FORTUNE: HOW SUCCESSFUL COMPANIES BUILD WINNING REPUTATIONS* (2004); CHARLES J. FOMBRUN, *REPUTATION: REALIZING VALUE FOR THE CORPORATE IMAGE* (1996); KEVIN T. JACKSON, *BUILDING REPUTATIONAL CAPITAL: STRATEGIES FOR INTEGRITY AND FAIR PLAY THAT IMPROVE THE BOTTOM LINE* (2004); PAINE, *supra* note 119.

121. The concept of social capital refers to intangible assets encompassing features such as personal aptitudes, social cohesion, and competency in problem-solving—traits that are entrenched in and conveyed by cultures. See DEMOCRACIES IN FLUX: *THE EVOLUTION OF SOCIAL CAPITAL IN CONTEMPORARY SOCIETY* (Robert D. Putnam ed., 2002). Francis Fukuyama, one of the earliest scholars of social capital, notes “the improbable power of culture in the making of economic society.” FUKUYAMA, *supra* note 116, at 1. Fukuyama further explains that the notion of social capital “has to do with people’s ability to associate with each other,” which is vital “not only to economic life but to virtually every other aspect of social existence as well.” *Id.* at 10.

122. In the United States, the legal roots of the shareholder-centered view extend back to the landmark case of *Dodge v. Ford Motor Co.*, in which the Michigan Supreme Court held that a business corporation is organized primarily for the profit of the stockholders, rather than for the good of the community or its employees. 170 N.W. 668, 684 (Mich. 1919) (“A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes.”).

captured explicitly on the balance sheet, even if part of their valuation concerns their contribution to the bottom line.¹²³

People are apt to flourish in surroundings in which overall social progress and cultural advancement are taking place. Growth comes about as a cooperative—not simply an individual—enterprise. The ability of sizeable groups to operate in conjunction with one another generates social trust, one of the essential components of market activity. Fukuyama states that “[t]rust is the expectation that arises within a community of regular, honest, and cooperative behavior, based on commonly shared norms”¹²⁴ “These norms,” he notes, “can be about deep ‘value’ questions like the nature of God or justice, but they also encompass secular norms like professional standards and codes of behavior.”¹²⁵

The notions of reputational capital and social capital should both be brought squarely into the province of economic study. Both of these concepts capture intangible assets that businesses must cultivate. Although their origins are non-monetary, the resultant value of such assets can be reckoned in monetary terms. Established econometric theory is capable of making allowance for forms of intangible capital assets, such as social and reputational capital, just as it has for other varieties of capital—financial capital, organizational capital, human capital, and knowledge capital.¹²⁶

CONCLUSION

Contrary to the amoral forms of discourse in which it has customarily been framed, the financial crisis is freighted with moral and cultural significance. Attempts to understand the crisis purely in functionalist, mathematical, and legal terms inevitably lead to a distorted view that will not help in mustering the enlightened leadership required to advance beyond the crisis toward a preferable situation of a sustainable market ecology. In this regard, the current economic scandal provides a special opportunity to recalibrate moral standards for market participants.

Two vital components of market ecology—reputational capital and social capital—are in part created and deployed by market participants themselves. In this sense, we might refer to

123. See generally Jackson, *supra* note 117.

124. FUKUYAMA, *supra* note 116, at 26.

125. *Id.*

126. See Jackson, *supra* note 117, at 49–50.

them as micro intangible assets. Moreover, such intangible capital assets are created and deployed by the broader culture in which businesses operate. In this sense, we could speak of them as macro intangible assets. Whether we are talking about their micro or macro forms, reputational and social capital are fostered by cultivating moral virtue, according respect for human dignity, and advancing the common good, rather than aiming at profit maximization directly.

The ecology of the market, because of its deep dependence on spontaneous ordering and its imperilment in the face of constructed ordering, will be sustained more by increasing the stock of reputational and social capital (at both micro and macro levels) than by legal and regulatory intervention. The big lessons for leadership are therefore to be found in seeking moral reform rather than passing new laws.

In summary, there are two crucial points to bear in mind. First, there are grave perils in conceiving of the market as detached from the rest of society. Market failure points to a more general failure of responsibility, not only in business institutions but in the wider culture as well. This Article suggests how, by looking beyond the mindsets of the increasingly dehumanized fields of business management and economics and into a moral paradigm that sees the essential challenges as abiding in the hidden chambers of the human heart, we might approach the interconnected challenges of moral reconstruction and economic recovery.

Second, rather than ceding our freedom by responding with legal regulation, we need to look to moral reform. Regulation is no substitute for virtue. Stepping up government regulation in an attempt to enforce moral conduct in business will provide neither a satisfactory nor a lasting solution. What is lacking in the received narratives of the financial crisis is a robust conception of moral virtue, human dignity, and the common good. Adopting a wider moral-cultural mental model to examine the crisis has revealed that ultimately the economy and its current malaise rest not simply on observable and repeatable dynamics played out in housing and credit markets, but on a moral and cultural framework. If suffering the costly experience of our financial turmoil has not been enough, perhaps the foreshadowing of a much bigger collapse—that of our moral and cultural framework, which stands imperiled by the insidious and profound financial scandals beneath the crisis—will serve to summon us all to a higher calling.