A Surprising Way to Stop Bankers From Robbing the People

by Lynn Stuart Parramore via dulcie - Alternet *Monday, Jun 13 2016, 5:23am*
international / prose / post

> Does morality have a place in the realm of banking and regulation?
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> That it feels awkward to even raise the issue is convenient for bankers who engage in reckless and harmful activities every day without fear of punishment.

Ed Kane, professor of finance at Boston College, believes it's vital to discuss moral questions, in plain English, without abstractions. Following his own advice, he is blunt in characterizing some of the behavior in the banking industry in recent years: "Theft is a forced taking of other people's resources," he says. "That's what's going on here." Kane urges a deep inquiry into our culture to understand why bankers so commonly get away with crimes in the United States.

In 2007, just before the housing bubble burst, Goldman Sachs chief Lloyd Blankfein wrote to a colleague to discuss how the bank could deal with toxic mortgages — "cats and dogs" as he called them — on the books. Blankfein's bank went on to sell the toxic junk to unwitting investors who were told they were sound, while taking short positions on the very same securities. As the Financial Crisis Inquiry Report noted, one structured finance expert compared Goldman's practices to "buying fire insurance on someone's house and then setting it ablaze."

Still, Blankfein and his fellow bankers later pocketed billions of dollars from the American people in the form of a bailout. They profited at the expense of their clients and society. Nobody went to jail.

In Kane's view, the word "should" — used in the moral sense — needs to be reinserted into the vocabulary of bankers. Today's executives may spend a lot of time considering the question, "Could we get away with it?" but there is little focus on the question, "Is it right to do it?"

In a new paper for the Institute for New Economic Thinking, "Ethics vs. Ethos in US and UK Megabanking," Kane argues that when bankers make reckless and harmful choices while counting on unlimited taxpayer support to bail them out, they are plainly stealing. He calls it "theft by safety net." Through the safety net, Kane explains, big banks demand that the public provide protection and relief from distress. They put great pressure on the government, which acts as a middleman in the robbery, just as in a "protection racket." As Kane puts it, "the government then, by dint of its authority, takes the money from hapless taxpayers."

Why is this not considered a crime? Because, says Kane, ***politicians nearly everywhere are bought off by bankers, pure and simple.*** The regulators who might intervene are more worried about their careers and hopping through the revolving door between government and the industry.

In Kane's view, pernicious cultural norms within banks and regulatory agencies have crowded out fundamental moral principles. Regulators in both the U.S. and the U.K. are fully aware that the reckless pursuit of profits is one of the main reasons for the expanding scale and frequency of financial crises over the last 50 years, but they tend to approach the issue differently.

Kane sees things as much worse in the U.S., where, he observes, authorities are stuck on the idea of toughening corporate-level rules: capital and liquidity requirements, corporate fines, periodic stress tests, and so-called living wills. That's not enough, says Kane. The British have done this, but they have also supplemented corporate restraints and punishments by defining a new crime called "reckless misconduct leading to the insolvency of a bank."

Besides that, Kane notes, it has been long been illegal in the U.K. for an individual director to allow a corporation to issue new debt if he or she knew or should have known that the firm was insolvent. In the U.S., Dodd-Frank Act allows a limited clawback of stock-based bonuses in the wake of a bank failure, but it does not make individual bankers criminally responsible for actions that they should have known were reckless. Prosecutors typically settle lawsuits and bankers find ways to put taxpayers on the hook.

In the U.S., Kane argues, the Dunning–Kruger effect — a cognitive bias named for two Cornell researchers in which people can't recognize their own weaknesses — compounds the problem. If you don't recognize your inability to make sense of things using an ethical code, for example, how can you overcome the shortcoming? Part of the problem is that ethical codes have to be taught and practiced. "College education in the U.S. has been much more watered down," observes Kane. "In the U.K., people still have some training in philosophy that helps them to see the ethical implications of their actions."

Philosophy for financiers? Yes, says Kane. "When I present these ideas in Europe, I get much more enthusiastic reception than in the U.S., where people have this relativistic view of ethics." He argues that in America, there is a common perception that whatever feels good at the moment must be okay and that this kind of thinking justifies nearly any behavior. "Kant is still a force in modern philosophy," says Kane, "and he tries to develop an objective, non-theological reason for not hurting other people." Hurting others to please yourself, says Kane, is the essence of theft. It's a problem caused in part by ethical blindness.

"The regulators in the U.S. just don't see things ethically," notes Kane. "They see that they have tools, and they can do things with them to help them weather a crisis. They use the tools to put taxpayers in the hole. Even worse, this behavior worsens booms and busts and misallocations of resources that leave a lot of people unemployed when the bubble breaks. I've looked regulators in the eye and they tell me they just don't get it — they don't see the transfer of value to fat cats that bailouts entail through an ethical lens. They view it through the norms of their employer."

A code of ethics, says Kane, is what connects us. Acting in one's self interest may be the mantra of capitalism. But the self is not an autonomous unit; it is connected to other selves, as Kant emphasized: "Kant says that you can't escape that connection," says Kane. "Think of a couple in love. The other person's happiness is part of their own." On the other hand, "narcissistic individuals don't see themselves as connected. They do whatever makes them feel good in the moment and are unconcerned about the fallout." That, says Kane, is a dangerous way of thinking and at odds with thousands of years of thinking about how to approach morality. "All religions deal with that in not terribly different ways. It can't be right to make yourself happy by hurting someone else."

As Kane sees it, holding accountable the individual, rather than the corporation, is hugely important to dealing with crimes in the banking industry. "Individuals are the ones who act recklessly," he points out. "Banks don't act recklessly." The punishment of the individual is not a matter or revenge of retribution, it is about deterrence.

Kane believes changes are needed in the culture of banks and regulatory agencies, but of course by the time people enter jobs in those institutions, they are already well into adulthood and their ethical frameworks have already taken shape. Is it too late?

"It really gets down to our family structure," says Kane. "Many children are not being disciplined. They're not learning about their obligations to other people. They're learning only about the obligations of other people to them. When they sense that their parents are lying and cheating, well, it's seen simply as a betrayal."

The educational system in the U.S. doesn't help. "The thing that our schools teach better than anything else is how to copy. Who to copy from. How to get away with it," says Kane. Getting students to think about ethics is about more than simply adding an ethics course to the curriculum. It's about changing the incentives: "What people teach in ethics is the history of ethical theory. They don't teach operative ethics."

Kane believes that students need to be taken through numerous real life scenarios in which they can apply ethical principles. In business schools, students get bombarded with case studies in which they look at a company, identify a problem such as poor sales, and try to figure out how to solve it. But, he argues, they need to go through well-designed ethical case studies. When your bank holds toxic mortgages, what should you do? What would Kant's model suggest that you do? What does the Golden Rule indicate as a course of action?

According to Kane, no amount of policy tweaks or added regulatory staff can solve this basic problem of ethics and cultural norms. There is no way around the necessity of inculcating an ethical perspective on the choices we make.

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