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The Ethics of Risk and the Economic Crisis

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Is the current economic crisis the result of bad judgment or unethical behaviors?
In this case it might not be possible to separate the two. Many people's poor financial decisions were driven by poor ethical decisions. Frank Vogel, cofounder of Transparency International, a nonprofit that ranks nations by degree of corruption, remarked, "so many people engaged in so many aspects of finance have lost their ethical compass and put short-term personal gains above other considerations."[1] When lack of wisdom is so widespread it seems wise to consider the larger culture.

Obviously the causes of the current economic downturn are multiple, complex and extremely difficult for a layperson like myself to understand. How exactly did the subprime mortgage industry, with its strange financial gadgets, take advantage of lack of oversight to create this crisis? I'm not sure. However, many experts have pointed to ethical factors that are easier to understand. For example, David DeRosa of the Yale School of Management commented that the "housing problem lies more in reckless unwise decisions on home financing…. Part of the difficulty arose from poor risk assessment."[2] To the best of my understanding, lenders and barrowers were involved in highly risky loans and people failed could not pay back these loans, it ignited a global, economic forest fire.

The theme of imprudent risk management frequently appears in commentaries on this economic crisis. For example, the commentator, Jared Bernstein writes: "One way to view the current economic crisis is as a pervasive failure to manage risk."[3] In general terms, unwise risk management can be an indication of a weakness in moral character and mixed-up values. It can be an indicator of character traits we want to avoid like pride, indifference, greed and irresponsibility.

In terms of moral character people who take imprudent risks sometimes have an excessive self-confidence, pride—the kind that comes before a fall. They overestimate their powers and abilities, which leads them to underestimate risk. In this way the latest economic crisis resembles the Enron scandal. Enron's CEO, Jeffery Skilling felt he was the smartest guy in the room, to quote one of the

[1] David R. Francis, "Economic Slump: Ethics Loom Large," *Christian Science Monitor*, September, 15, 2008.
[2] Ibid.
[3] Jared Bernstein, "Risk Manager-in-Chief," *Huffington Post*, October, 12, 2000

books on the scandal. Skilling was an extremely bright person who enjoyed taking risk and exploiting opportunities that only clever people could find. The culture at Enron reflected his personality; it favored people who took great risks based upon the belief that they were smarter than the other guys, and the regulators. Similarly one has to wonder if too many people were overconfident that their cleverness was a sufficient guarantee for the financial bets.

The Enron scandal also provides an example of other ways imprudent risk management indicate moral problems, it can be a sign of indifference and irresponsibility. The leaders of Enron took great business risks that were spectacular failures. They failed to take responsibility for their risks and ultimately tried to them cover-up with illegal accounting practices. One of the main ethical accusations against the leaders of Enron was their indifference and their lack of responsibility to their investors, many of whom were Enron employees who lost everything. We tend to give an ethical pass to people who take risks if they are the only one put in peril by their actions. However, no such pass is given to people who take imprudent risks for personal gain, while putting others in danger. In hindsight this seems to one of the major areas of ethical concern in the current crisis. The economic well being of everyone has been damaged by a system that allowed so many high risk subprime loans.

Imprudent risk management can also be an indicator of mixed-up values. It can be an sign of greed. There is a relationship between the kinds of risks that we are willing to take and how much we value something. The higher we value something, all things considered, the greater risks we are willing to take to attain them. For example, parents will put their lives at risk to save their children. However, some things just do not seem to be worth the risk. Were the financial risks worth the possible gain for many of the failed agreement driving this crisis?

Over the last three decades we’ve experienced a series of financial crises that have grown in magnitude, from the Savings and Loan collapse in 1980s, to the Enron scandal, to the current Subprime mortgage crisis. Perhaps a common thread that runs through these crises is poor risk management, and this can be an indicator of a lack of good moral judgment. As I indicated at the start of these brief remarks, when lack of wisdom is so widespread it seems wise to look at the larger culture. What is it about our current culture that is leading to so much imprudent financial risk taking?