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Greed, Capitalism and the Financial Crisis

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Introduction

As the world entered and suffered through the recent Great Recession, certainly the worst economic slowdown in a generation, people naturally asked: what went wrong? Although many answers have been suggested, one thing many observers point to is the decisive role played by unmitigated **greed**.

Greed by the managers of financial institutions led to easy loans with little to no down payments. Greed by homeowners led to purchases of houses they couldn't afford. Greed on Wall Street led to the creation of clever new financial instruments like mortgage-backed securities and credit default swaps. Greed by CEOs led to corporate extravagances and ridiculously high executive compensation packages. Greed by consumers led to excessive use of credit cards to buy things now, rather than wait till they earned the money to pay for it. Greed by companies led to offshoring and the substitution of lower cost foreign labor for higher cost domestic labor.

John Steele Gordon, author of a book on financial history wrote "... there is no doubt at all about how we got into this mess. ... Greed, as it periodically does when traders and bankers forget the lessons of the past, clouded judgments."¹ Ralph Nader said "pure greed" was clearly the cause of the crisis.² Dr John Sentamu, the Archbishop of York, attacked exploitative money lenders who pursued "ruthless gain" and urged banks not to "enrich themselves at their poor neighbours' expense".³ Pope Benedict in his 2008 Christmas message said, "if people look only to their own interests, our world will certainly fall apart."⁴ The Dalai Lama asked, "what is the real cause of this sort of economic crisis?" His answer: "Too much speculation and ultimately greed."⁵

Steven Pearlstein noted in October 2008 that "a clip search of major publications during the previous month turned up about 2,700 stories that contained the words "Wall Street" and "greed." One month earlier there were less than 200."⁶

¹ <http://freakonomics.blogs.nytimes.com/2008/09/22/john-steele-gordon-on-the-financial-mess-greed-stupidity-delusion-and-some-more-greed/>

² Financial Crisis Pure Greed, http://www.upi.com/Top_News/2008/09/16/Nader_Financial_crisis_pure_greed/UPI-43731221599036/

³ Religious leaders blame bankers' greed for financial crisis, <http://www.telegraph.co.uk/news/newstoppers/religion/3949359/Religious-leaders-blame-bankers-greed-for-financial-crisis.html>

⁴ Church leaders offer comfort but little joy in lessons on economy, <http://www.timesonline.co.uk/tol/news/politics/article5397933.ece>

⁵ The Dalai Lama blames "greed" for financial crisis, <http://www.neurope.eu/articles/90974.php>

⁶ Pearlstein, Steven, Greed Is Fine. It's Stupidity That Hurts, <http://www.washingtonpost.com/wp-dyn/content/article/2008/10/02/AR2008100203633.html>

Popular Perceptions of Greed

Greed is an easy target, it is not hard to convince most people that greed is the primary source of many of our economic woes. But is it really? Pearlstein also pointed out what many economists believe. He wrote, “In a capitalist economy like ours, the basic premise is that everyone is motivated by a healthy dose of economic self-interest -- the shopper looking for the best bargain on tomatoes and the farmer looking to get the highest price for his produce, the grocery clerk looking to earn the highest wages for restocking shelves and the investor looking to earn the biggest profit from Safeway stock. Without some measure of greed and the tension it brings to most economic transactions, capitalism wouldn't be as good as it is in allocating resources and spurring innovation.”

This is the central idea behind Adam Smith's oft-quoted line about the butcher, the brewer and the baker in the *Wealth of Nations*,

“It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages.” (Smith *WoN*, : [B.I, Ch.2, Of the Principle which gives Occasion to the Division of Labour](#) in paragraph I.2.2)

Smith is arguing that the economic system provides for our wants and needs because, first and foremost, people are trying to help themselves, and they do so by producing and selling meat, beer and bread to others. These market outcomes are not achieved because of charity. We do not appeal to other peoples' *humanity* when we seek our sustenance, but rather to their self-interest, their *greed*. Nonetheless the modern economist's acceptance of greed as a positive force in society has not been readily accepted especially given centuries of moral teachings to the contrary.

The world's religions, almost unanimously, contend that greed is morally repugnant and evil. Although not explicitly proscribed in the ten commandments, greed is implicated in the command not to covet one's neighbor's property or spouse. The Bible contends that “the love of money is the root of all evil.”⁷ Later in 590AD Pope Gregory declared greed to be one of the seven deadly sins, along with lust, pride, gluttony, sloth, envy and wrath. Among the seven though, greed is considered by many to be one of the worst, if not, *the* worst of them, mostly because greed can be instrumental in inspiring many of the other sins.

Indeed in almost every major religious tradition and in the writings of religious leaders, greed is condemned unequivocally. The Koran states, “whoever is saved from the greediness of his soul, these it is that are the successful”⁸ The Tao Te Ching states, “when there is no desire, all things are at peace.”⁹ In the Bhagavad Gita, the Lord

⁷ Timothy 6:10

⁸ The Koran, The Mutual Deceit, C 64, v16. <http://quod.lib.umich.edu/k/koran/browse.html>

⁹ Tao Te Ching, Chapter 37,

Krishna declares, “There are three gates leading to this hell—lust, anger and greed. Every sane man should give these up, for they lead to the degradation of the soul.”¹⁰ Finally, Sulak Sivaraksa, a leading Buddhist writer, states that “corporatism depends on greed ... and is ... an anathema to the goals of Buddhism.”

A strong objection to greed and its embodiment in business dealings is a common theme in Hollywood movies. Movies like *Wall Street*, *Pretty Woman*, and *Other People’s Money* incorporate corruption and shady dealings on Wall Street. The *China Syndrome*, *Erin Brockovich*, and *A Civil Action*, all show how business leaders will ruthlessly sacrifice the environment to earn greater profit. Similarly in the *Insider* and *Runaway Jury* they make the popular case against the tobacco and gun industries as businesses willing to tolerate the deaths caused by their products in order to enrich their bottom line.^{11,12} These movies suggest that greed and profit seeking are both a common feature of business and the source of many injustices. The heroes in these movies are the individuals, often the downtrodden or disadvantaged, who fight to reveal the injustices and overcome the problems caused by greed.

Perhaps the most notable example in recent years was the portrayal of business in the movie *Wall Street* (1987), made in the heady days of the free market Reagan administration. The villain of the story was Gordon Gekko (Michael Douglas) who plays a powerful head of a mergers and acquisitions firm. Towards the end of the movie he makes a now well-known speech about why “greed is good,” that is meant to highlight the arguments made by business people and free market advocates. Gekko tells a group of shareholders of a company he is trying to acquire that,

“Greed, for lack of a better word, is good. Greed is right, greed works. Greed clarifies, cuts through, and captures the essence of the evolutionary spirit. Greed, in all of its forms; greed for life, for money, for love, (for) knowledge has marked the upward surge of mankind.”

Of course, true to Hollywood form, in the end Gekko winds up implicated in a major fraud revealing the true moral of the story, which is, of course, that “greed is bad!”

The same lesson from the movie *Wall Street* seems to be playing out for real in the world today. Consequently, it was natural for Hollywood to make the sequel titled *Wall Street: Money Never Sleeps*, that opens in theaters in Fall 2010. These events are certain to reinforce the popular impression of the immorality of greed.

Tom D’Antoni in the *Huffington Post* recently resurrected the popular adage from the *Wall Street* movie and declared that, “ the concept that "Greed is Good," is dead. It rose to its despicable zenith in tandem with the rise of Reagan, and has been the guiding principle of industry, finance and government ever since. Greed brought us to this place...unregulated, untrammled, vicious greed. Greed has no morals or ethics.

¹⁰ Bhagavad Gita, 16.21, <http://www.bhagavad-gita.us/categories/The-Gita%3A-Chapter-16/>

¹¹ Ribstein, Larry E. 2005. *Wall Street and Vine: Hollywood’s view of business*. Working Paper LE05-010, University of Illinois Law and Economics,

¹² Steven M. Shugan, *Antibusiness Movies and Folk Marketing*, *Marketing Science*, Vol. 25, No. 6, November–December 2006, pp. 681–685

Greed has no regard for others. Greed feeds only the greedy and feeds on every thing and every one within grasping distance.”¹³

An Alternative to Greed

So if not greed, then what? The typical solution to greed is to invoke its opposite, altruism. Across the world in churches, synagogues, and mosques, people learn that the right and proper way to live is not to be self-centered and greedy, but to be altruistic; to give to others. Indeed, for each of the seven deadly sins there are seven virtues that Christians and others generally aspire to. The virtue representing the opposite of greed is charity.

For many, charity is a moral imperative. Christians are taught the story of the Good Samaritan from the Book of Luke in the New Testament. In the parable, Jesus tells of a traveler who is robbed, stripped and left for dead. Two people pass him by, but leave him in distress. Later a Samaritan stops and provides assistance; giving of his time and resources in a charitable response. Similarly, the Koran encourages Muslims to “give food out of love for Him to the poor and the orphan and the captive: ... only feed (them) for Allah's sake; .. desire ... neither reward nor thanks.” In both cases, giving to others, especially those in greater need, is considered morally righteous. One is encouraged to give and to expect or demand nothing in return. In other words, charity is a virtue, whereas it's opposite, greed and self-interest, are vices.

Praise for charity is prominent in oft-quoted remarks by authors, politicians and scholars. For example, Winston Churchill said, “We make a living by what we get, but we make a life by what we give.” Maya Angelou, the well-known novelist said, “I have found that among its other benefits, giving liberates the soul of the giver.” Marian Wright Edelman said, “Service is the rent we pay to be living. It is the very purpose of life and not something you do in your spare time.” Finally, John F. Kennedy said, “Ask not what your country can do for you, but what you can do for your country.”¹⁴

Each of these statements highlights the high regard most people have for giving, service and charity. Living by this morality proves to be enormously difficult and yet most religions have continually taught that this is the true path to salvation and enlightenment. One problem though is that no one has ever presented a convincing description of a world devoid of greed and self-interest and sustained entirely by charity and good will towards others. Perhaps the best statement of that ideal is found in the writings of Karl Marx and summarized in the well-known phrase, “from each according to his ability, to each according to his need.”¹⁵ Presumably a society based on this principle would not contain greedy individuals who produce only for their own needs, but only those who would give freely to the general needs of society. For those who cannot produce enough to satisfy their own needs, the charity of others would sustain them.

¹³ D'Antoni, Tom, “Finally the Death of Greed,” The Huffington Post, http://www.huffingtonpost.com/tom-dantoni/finally-the-death-of-gree_b_150406.html

¹⁴ Found online at Wisdom Quotes (http://www.wisdomquotes.com/cat_giving.html)

¹⁵ Karl Marx, Critique of the Gotha Program, 1875.

A society like this is hard for many to imagine. Perhaps this is because humans are by their nature imperfect beings and most cannot understand or realize the divine. For example, Dr. Meir Tamari, discussing charity in the context of Judaism writes,

If people really believed that all their needs would be satisfied as a result of God's mercy and providence, then they would not hesitate to share their wealth with others. Indeed, the refusal to share wealth with others is a denial of trust in God, a rejection of God's merit as the provider of the needs of man, and an assumption that that wealth is the result solely of one's work, ability, or luck. The selfishness of the people of Sodom and their imitators in all societies is actually a form of idolatry, since it negates the Divine Source of all wealth.¹⁶

Perhaps Dr. Tamari is right, but the vision he suggests seems utopian and unlikely to be realized by most worldly people. Thus, a real world society based on charity alone may be unachievable.

Seeking a middle way

Is there a resolution to the greed paradox? Is greed evil? Is it a necessary evil? Is greed something that humankind should seek to eliminate, perhaps replacing it with altruism? Or is greed something so ingrained in the human psyche that there is no hope of eliminating it? Perhaps we simply need to learn how to live with greed. Perhaps there is a middle way, a method of channeling greed in positive rather than negative ways.

Aristotle argued that, "...virtue is concerned with passions and actions, in which excess is a form of failure, and so is defect, while the intermediate is praised and is a form of success."¹⁷ It is the middle way that is the goal. Thus, in the pursuit of pleasure, temperance is the mean, or average, between the excess of intemperance (perhaps greed) and the deficiency of insensibility. Similarly generosity (or charity) is a mean between the excess of prodigality and wastefulness and the deficiency of stinginess. Perhaps the choice isn't to eliminate one (greed), in favor of the other (charity), but rather to find a happy median instead.

Indeed, dictionary definitions of greed highlight not only self-interest but an "*intense*, selfish desire"¹⁸ or "an *excessive* desire to acquire or possess more than one needs or deserves."¹⁹ Greed is usually not implicated if someone's desires are average or if one achieves a moderate standard of living.

Religious writings themselves sometimes take account of this. Thus, one hadith, a saying of the prophet Muhammad, states, "eat what you want and dress up as you

¹⁶ Dr. Meir Tamari, Judaism's Encounter with Greed, http://www.myjewishlearning.com/daily_life/Tzedakah/TO_Tzedakah_Th_and_Th/Judaism_on_Greed.htm

¹⁷ Nicomachean Ethics, Book 2, Chapter 6. http://www.constitution.org/ari/ethic_00.htm

¹⁸ New Oxford American Dictionary

¹⁹ American Heritage Dictionary of the English Language, 2006.

desire, as long as extravagance and pride do not mislead you”²⁰ In Judaism too, one Midrashic interpretation asserts, “were it not for the yetzer hara (the evil urge), a man would not build a house, take a wife, beget children, or engage in commerce.”²¹

Returning to the issue of our current financial crisis, some commentators recognize that greed cannot be eliminated. Michael Lewis and David Einhorn of the New York Times write, “‘Greed’ doesn’t cut it as a satisfying explanation for the current financial crisis. Greed was necessary but insufficient; in any case, we are as likely to eliminate greed from our national character, as we are lust and envy.”²² Robert Sidelsky also writes that “(John Maynard Keynes) believed that material wellbeing is a necessary condition of the good life, but that beyond a certain standard of comfort, its pursuit can produce corruption, both for the individual and for society.”²³

Finally, Steven Pearlstein suggests a different perspective, that greed may not be about the degree of desire, or how much one acquires, but with *how* one acquires their wealth. He writes, “even before they decided to give away most of their money, nobody seemed to begrudge Bill Gates or Warren Buffett their billions or criticize them for their “unbridled” greed. That seems to have a lot to do with the fact that Gates and Buffett made their money on the basis of their own ingenuity, skill and hard work.”²⁴

These latter suggestions may provide an answer to how much greed is acceptable. Rather than focusing on *how much* one acquires as a measure of the excessiveness associated with greed, perhaps excessiveness can be defined, instead, in terms of the *method* used to acquire things.

Methods to Satisfy Greed

The American economist Henry George (1839–1897) is mostly famous for his writings about appropriate taxation policies on land, but in his book *Protectionism and Free Trade*, he had a passage that can help resolve some of the tension about profit seeking. He wrote, “is it not true, as has been said, that the three great orders of society are ‘working-men, beggar-men, and thieves?’” Prima facie this passage may seem unremarkable, perhaps even confusing; after all what exactly is an “order of society?” But if we think about it carefully in light of the current discussion, it actually provides the seeds, or kernels, for understanding this issue.

²⁰ The Prophet Muhammad, as reported by Abd'Allah ibn Abbas. in *Is Your Faith the Greediest?*, <http://www.beliefnet.com/Faiths/2002/07/Is-Your-Faith-The-Greediest.aspx>

²¹ *Is Your Faith the Greediest?*, <http://www.beliefnet.com/Faiths/2002/07/Is-Your-Faith-The-Greediest.aspx>

²² MICHAEL LEWIS and DAVID EINHORN, *The End of the Financial World as We Know It*, NYT Jan 3, 2009. <http://www.nytimes.com/2009/01/04/opinion/04lewiseinhorn.html?ref=opinion>

²³ *Where do we go from here?* Robert Skidelsky, Prospect | Wednesday, December 17, 2008, <http://www.skidelsky.com/site/article/where-do-we-go-from-here/>

²⁴ Pearlstein, Steven, *Greed Is Fine. It's Stupidity That Hurts*, <http://www.washingtonpost.com/wp-dyn/content/article/2008/10/02/AR2008100203633.html>

First, let's recognize that what he really refers to are the three primary ways in which people obtain benefits for themselves, or in other words the ways people "profit." As we'll soon argue, how a person ultimately judges profit-seeking activities and whether he or she views greed as good or bad will depend largely on which one of George's "great orders" is believed to be most prominent in society. But first let's discuss each of these profit acquisition methods in a bit more detail, beginning with the last one, "thief."

Theft, or Involuntary Transfers

One of the methods a person can use to satisfy his greed for food, clothing, automobiles, cameras, computers, or the money to acquire these things is simply to take it away from someone else who has the desirable products. Theft has been a part of life in societies since the beginning and it is likely to remain a part of society for a long time to come.

However, for theft to occur, or even be defined, it is necessary to assume one other thing; namely that there is *property* or *possessions*. Theft cannot occur without ownership. If we didn't believe that the car is "mine," or the wallet is "his," or her body is her own, then we could never conceive of a concept like theft.

When the rightful owner of something has that item stolen away by another, the thief clearly benefits since he is now in possession of the valued item while the victim will suffer a loss since he does not possess and can no longer receive the benefits from the product. The victim will surely feel that an injustice has occurred and will demand the return of the stolen property and the punishment of the perpetrator, if those responses are at all possible. Regardless of what happens afterwards though, theft involves a transfer of an item from a legitimate possessor to an illegitimate possessor, and the transfer always occurs involuntarily. Thus the term involuntary transfer offers a better moniker for this action because it will later be applied to situations that may technically not be considered theft, but which has similar characteristics.

Around the world societies evaluate theft in similar ways. It is generally considered bad, or wrong, or perhaps evil, with perhaps only a few exceptions tolerated.²⁵ However, these exceptions are rare and societies have put into place an elaborate system of laws that prohibit theft in a variety of situations while providing penalties for those found guilty of having violated these laws. Suffice to say the obvious then; the acquisition of benefits via theft is unacceptable in all societies around the world. Or in other words, profit seeking, or greed, that is satisfied via theft is generally regarded as wrong.

Although this is a seemingly obvious point, it actually forms the basis for most of the cry outs about injustices around the world. In brief, people claim an injustice whenever they perceive that someone is getting "ripped off" in some way. Later I will

²⁵ For example, some may accept the necessity of theft in a desperate situation, as when it would relieve a potentially life threatening outcome.

consider several examples of perceived injustices during the recent financial crisis. In each of those cases I will argue that injustice is claimed because of a perception that an involuntary transfer, or ripoff, is the source of profit for a particular group.

Beggar Man, or Voluntary Transfers

The second of George's orders of society, that is, another main way in which people can acquire the goods and services that their greed inspires, is to be given the products voluntarily by another. A beggar stands on the street corner and solicits money from passersby. That money represents a transfer of goods and services from the giver to the recipient. Although the giver loses, the money obtained by the beggar is not ill begotten because it has been given to him willingly; it is a voluntary transfer.

From the giver's perspective this action is called charity and as mentioned above, the action is held in high esteem in most societies in the world. Charity is not self-serving, but is in the service of others. It is not harmful, but helpful. Charity is encouraged and promoted in all of the main religions. Some, like Mother Teresa, who have spent their lives giving to the most needy in the world, have been made saints to glorify their accomplishments.

Of course, praise for charity is generally reserved for the giver while much less discussion is heard regarding the receiver. Perhaps this is because it is generally presumed that the recipient is in great need or else he wouldn't be begging or looking for a handout. Few of us would willingly beg for our sustenance if there were another way to survive.

However, in other instances benefits acquired via voluntary transfers have a questionable reputation. Consider a woman who might be described as a gold digger. A gold digger is a woman who seeks to marry a wealthy man so she can live in a large home, drive an expensive car, and wear expensive jewelry and clothes. In other words she obtains all of her consumption items, in effect, from the generosity and charity of her husband. Of course one wouldn't normally call this charity, but it surely is a voluntary transfer between individuals. Behavior like this occurs in all societies and there is typically a strong aversion to being characterized as a gold digger, suggesting the generally negative impression it generates. Nonetheless, in defense of the practice, one can always emphasize that the transfers are completely voluntary.

Working Man, or Voluntary Exchange

The third order of society that George mentions is "working man." This represents the third method an individual can use to acquire the goods and services that his greed may inspire. Work clearly generates an income that can be used to purchase consumption goods, but it is important to recognize the underlying process. Work is an activity to produce a good or service that someone else will wish to purchase; a product that is desirable. Through the free voluntary exchange of the product for money in the

marketplace, a business generates the revenue that is used to pay its workers. That money, or income, is then used by the workers to purchase other goods and services produced by other workers. In the end, when you strip away the money part of the transactions, what is really taking place via market activity is the voluntary exchange of one good for another. And since both parties to a trade exchange voluntarily, it must be that both benefit from the transaction, for if not, why trade?

Voluntary exchange represents the cornerstone to economic prosperity in the world. One of the first lessons in economics is the principle of the division of labor, which says that the productivity of a good can increase as the production process becomes more specialized; that is as labor or workers are divided into specialized tasks.

For example, imagine how productive four people would be if they each produced all of their own meat, grain, vegetables and fish for themselves; compared to a community consisting of a shepherd, a grain farmer, a vegetable farmer and a fisherman. Surely the community of specialists would be able to produce a greater total amount of food because each one would become more skilled in his own profession. Nonetheless, the abundance created by the specialists does not benefit the members of the group unless they can exchange their products with the others through voluntary exchange. If the shepherd must eat only meat, and the fisherman only fish, etc., then individuals might prefer to produce everything on their own and consume less. But if they can exchange their meat for grain and fish and vegetables, then everyone in the community will benefit from the increased production. However, these benefits can only arise with voluntary exchange.

Based on this fundamental principle, economists have long supported free markets, which essentially means allowing free and voluntary exchanges without impediments. Indeed, societies everywhere generally accept and promote trade both within and beyond their borders. There is no community or society in the world that does not benefit from the voluntary exchanges and market activities that occur in abundance in every day life. In a nutshell then, if greed inspires work that in turn inspires voluntary exchanges in the marketplace, then the outcome is good for everyone involved.

Distinguishing “Good” Greed from “Bad” Greed

In summary then, greed can generate either positive or negative outcomes depending on which great order of society, or in other words which method, is used to satisfy that greed. If greed inspires a person to work long hours to earn income in a business providing valuable goods and services to others in order to satisfy the needs of himself and his family, then greed is perfectly acceptable. If greed inspires a person to innovate and create new products that others will desire in the market, then greed is good. In each of these cases greed is satisfied via voluntary exchange. However, if greed inspires a person to acquire that which he desires by taking involuntarily the rightful possessions of another person, then greed is not good. Greed is also wrong when it inspires someone to place roadblocks in the way of others trying to sell their products in

the market place. In both of these cases greed is satisfied via involuntary transfers and is rightly condemned. Finally though, if greed for even a basic sustenance inspires one to beg for food and clothing, or to seek out the charitable contributions of others, and if those items are indeed given voluntarily, then again greed is satisfied in an acceptable manner. The compassion of those who are charitable, helping those who are less fortunate, engaging in voluntary transfers is clearly unobjectionable.

Under this more carefully delineated definition, there can never be too much greed. We would never portray greed in general, as good or bad, right or wrong. Instead, under this definition, greed can be satisfied in either acceptable or unacceptable ways. The distinguishing feature isn't the presence of greed itself or even the intensity of the greed, but rather the way in which greed is satisfied. Even intense greed, if satisfied via hard work producing products that others wish to buy in the marketplace, is clearly good. However, greed satisfied by outright theft or by enacting schemes that effectively and involuntarily transfer money from others is clearly wrong. Following George's great orders, the greed satisfied by a working man is commendable, the greed of a beggar man is unfortunate but acceptable when necessary, whereas greed satisfied by thievery is the primary source of injustice in the world.

Reevaluating the Perceptions of Greed in The Economic Crisis

We can now use this framework to consider whether greed is a prime cause of the current economic crisis. First let's revisit some of the arguments made by those who see greed as the major source of the crisis and contrast their points of view with defenders of the system. In doing so, we can see that greed is perceived either positively or negatively depending on which great order of society the observer believes is more prevalent.

For example, one of the things contributing to the housing bubble preceding the economic crisis was the expansion of subprime mortgages. These mortgages were subsequently defaulted on in large percentages and led to some of the initial financial insolvencies. To some, the originators of these loans were too greedy and took advantage of their intermediary position between naive borrowers on the one side and the mortgage backed security system on the other side.

The lenders making the subprime loans earned money on the closing fees and thus the greater the number of mortgages originated the more money they would make. Critics contend that many lenders made loans to borrowers they knew would never be able to repay the loans. These borrowers were tricked into thinking that house prices would rise forever and were encouraged to purchase the most expensive home for which they could afford the initial monthly payment. Monthly payments were kept low by offering creative new loans, some of which required no money down while others required payment of only the interest and no principal. The lenders did not worry about the risk of default because once the loan was made it was typically resold to another financial firm that would bundle the security into a mortgage backed security (MBS) to be sold to large investors.

Clearly the lenders made a lot of money, but at whose expense? The homebuyers who eventually default lose their homes and the ability to borrow money in the future. In another sense though, they gain, because they were the recipients of transfers, the mortgage loans, for which they did not repay entirely. That means the other losers are the holders of those mortgages, the purchasers of the MBS. They have purchased an asset that has fallen significantly in value and they can expect to receive back much less than they paid for the securities. In essence, they are the victims of involuntary transfers because they lent money that was not returned.

And still, it is difficult to argue that the large investors have been duped. All transactions, and especially loans, have a chance of going bad. Investors know this and plan for it. MBS purchasers should be among the most sophisticated of all the groups since as large investors, they likely have big research teams that help assess risk. However, if outright fraud occurs, such as if the mortgages were sold under false pretenses concerning their characteristics, then this would be an example of an involuntary transfer from the MBS purchasers to the loan originators. In any case, the argument made is that greed inspired the excessive lending practices, caused investors to ignore the risks, and resulted in the borrowers and the MBS purchasers being ripped off by the loan originators.

On the other side, one could argue that the lenders entered into contracts with the borrowers that represented free and voluntary exchanges. No one could have known that the markets would crash and home prices would fall. The lenders communicated the terms of the loans to the financial firms who purchased them and those firms classified them on the basis of their riskiness. The investors who purchased the MBS also entered into mutually voluntary transactions and should have known better than anyone the risk associated with the subprime MBS. Indeed, if the risk of the loans and if the expected default rates were too high then the investors should know enough not to buy too many of them, and if that were true, then the banks would quickly learn not to originate as many new loans because there would be no secondary market. Thus, as long as the information that could have been known to everyone at the time was communicated, in other words, as long as there was no fraud, then the outcomes, while unfortunate, were not akin to someone being unfairly ripped off.

A second related issue concerns the government loans made to several of the largest banks in the US such as Citigroup and Bank of America, and the government takeovers of Fannie Mae, Freddie Mac and AIG. Given the fear that a systemic run on banks could have led to a collapse of the entire financial sector, it was not too surprising that government bailouts occurred. The takeovers of Fannie and Freddie were especially likely because, as quasi-government agencies, most observers expected there was an implicit government guarantee. The takeover simply made the implicit guarantee explicit. The other interventions were perhaps less expected but the size and importance of these institutions may have contributed to a moral hazard problem and helped cause the excessive lending that occurred earlier.

A moral hazard occurs if lenders expect that the government will come in and bail out institutions that get into financial difficulty. Thus, if lenders believe that their institution is too big to be allowed to fail, then highly risky lending practices or excessive exposure to MBS may be stimulated since the severe downside risk is discounted. Thus, why not make large loans to customers who don't document their earnings, or who don't have a down payment? If the housing bubble bursts, losses are covered by a government bailout.

The problem with the bailout then is twofold. First, the expectation of a bailout can actually contribute to the bad behavior that induces the crisis. The second problem is that a bailout effectively amounts to a transfer of money from taxpayers to the institutions that made the bad decisions. Since taxpayers have little say in the matter as the crisis unfolds, it is reasonable to argue that the transfers are involuntary. Thus, the greediness of financial firms, protected from severe downside risk by an implicit "too big to fail" intervention, effectively rips off the taxpayer when things go very badly.

A related irritation that led to cries of injustice by the general public concerns the bonuses paid to executives at the financial firms that were bailed out by the government. After the billions of dollars from the TARP were transferred to these failing institutions, many of the banks were quickly out of trouble and the systemic crisis was averted. However, announcements that these same companies would pay millions of dollars in overdue bonuses to executives touched off a wave of indignation.

The source of the anger is fairly obvious. In the midst of the crisis these institutions laid off a large portion of their workforces and it was their overextended positions on loans and their large size that contributed to the crisis. Since bonuses are typically made to reward good behavior, it seemed especially inappropriate for executives who were implicated in the crisis and who were saved largely due to a taxpayer financed bailout to be able to walk away a few months later with hefty bonuses. Reward seemed to be disconnected from achievement.

Admittedly, the bonuses were announced only after the banks were profitable again and after they had repaid the government loans. Nonetheless, most observers would contend that transfers from taxpayers put these companies back into the position of being profitable and it was not because of the skill and hard work of these executives. Thus, again there is a sense that involuntary transfers from taxpayers who, despite the representative democratic decision process, feel as though they have little say in the matter, is what enabled the very high salaries of a few individuals.

The key for high salaries to be viewed as equitable, or just, is that they are deserved. As mentioned earlier, very few people seem to begrudge the high salaries and enormous wealth of figures like Bill Gates, founder of Microsoft, the Sam Walton family, who together run the retail chain Walmart, or Larry Page and Sergey Brin, cofounders of Google. In each of these cases wealth is associated with a good or service that is well known to be useful and valuable. The same might be said for the high earnings of well-known sports figures, like David Beckham in soccer, Alex Rodriguez in baseball, Roger

Federer in tennis and Tiger Woods in golf. In all of these instances earnings are clearly the result of the voluntary exchange process. Each of these individuals earns money by providing goods and services to a large number of individuals and businesses around the world.

In contrast, one of the problems with high incomes in the financial sector is that it is much more difficult to see the value of the products being produced. Although many can understand the principle that there is some value in “managing risk” for financial institutions, it remains hard to see why so many millionaires were created in the process. And if the suspicion is true and they are not making money the old fashioned way by creating valuable products for others, then possibly they are making their fortunes via some sort of poorly recognized transfer process. In other words, maybe they are ripping someone off in route to their fortunes. These suspicions are fueled in book accounts by former financial insiders, who write about shady dealings inside the system.²⁶

Then of course there are the clearcut shady dealings of too-good-to-be-true financial wizards like Bernie Madoff. In this scandal, Madoff offered investors better than expected returns largely by fabricating them in their financial statements and by using the principal deposited by new investors to pay the returns of investors lucky enough to get out early. His setup was a classic ponzi scheme that inevitably came tumbling down when the financial crash hit and too many people demanded their money back at the same time. Clearly Madoff was greedy, as were the investors who were looking for better returns. However, this case is a clear example of greed fueling involuntary transfers rather than valuable production and trade. Greed channeled in this way is clearly unfair and unjust.

Although outright fraud may have played some small role in the crisis it is unlikely to have been a prime motivator. Also, for the most part, cases of fraud do not require a change in public policy to correct, although there may be a need for changes in enforcement. Bernie Madoff was eventually caught and prosecuted under current laws. The same was true for Ken Lay of Enron, Bernard Ebbers of Worldcom and Michael Millkin of Drexel Burnham and many others. Nonetheless these examples of fraud are clearly motivated by greed and tend to tarnish many people’s perception of economic activity. Indeed most of the Hollywood movies mentioned earlier that disparage business typically envision some sort of deception and fraud.

And this turns out to be the critical factor in interpreting greed’s role in the financial crisis. Those who argue that greed played an important role, tend to also believe that deception and fraudulent practices are widespread in the financial sector and in business generally. They likely believe or suspect that many of the rich became rich at the direct expense, and hence due to a transfer from, low paid workers, consumers or taxpayers. Those who downplay the role of greed, tend to see firms attempting to satisfy market demand. Mortgage backed securities are marketed and sold because there is a demand

²⁶ See for example Michael Lewis books, *Liar’s Poker* and *the Big Short*, William Cohan’s *House of Cards* and Lawrence MacDonald’s *A Colossal Failure of Common Sense*.

for them. Credit default swaps are there for the same reason. Excesses, when they occurred, are more likely the result of government policies that created the moral hazard problems, as with the implicit guarantees of Fannie and Freddie, the regulations that stimulated mortgage supply to low income households, and because of the too-big-to-fail interventions. In other words, to defenders of the free market, the system failed because there was too much government regulation and intervention.

Using Henry George's great societal orders to interpret the viewpoints, critics of greed tend to see greed satisfied through involuntary transfers whereas defenders of the system tend to see greed satisfied via voluntary exchange and free market activity. What is important to recognize is that both sides are right. Of course greed inspires voluntary exchange and the associated market activity. But greed also leads others to engage in deception, fraud, and other sophisticated methods designed to rip other people off. Adding to the confusion, many times, people and businesses are satisfying their greed using both methods at the same time.

Greed and Government

Indeed one of the most lucrative ways for legitimate businesses to induce some involuntary transfers to bump up their profit to higher levels is with the assistance and approval of the government. Government was implicated earlier as the source of the moral hazard problem and its too-big-to-fail bailouts. These policies come about largely because of the lobbying pressures brought to bear by businesses. Since the beginning of representative democracy, constituents have lobbied the government to implement favorable policies. Although the arguments used to support any suggested policies are generally made on behalf of the national interest, almost surely the policies, if implemented, will support the special interest of the soliciting party.

Robert Reich, writing in *American Prospect* recently, went so far as to describe this process as political corruption. He writes,

“If we define political corruption as actions causing the public to lose confidence that politicians make decisions in the public's interest rather than in the special interest of those who give them financial support, the biggest corruption of our political process is entirely legal. It comes in the form of campaign contributions that would not be made were it not for implicit quid pro quos by politicians, bestowing favors of one sort or another on the contributors.”²⁷

But what sort of favors does he mean? Reich continues,

“The fights that actually preoccupy Congress day by day, which consume weeks or months of congressional staffers' time and which are often the most hotly contested by squadrons of Washington lobbyists and public-relations professionals, are typically

²⁷ Reich, Robert (2010), “Everyday Corruption,” *The American Prospect*, June 21, 2010, (accessed online at http://www.prospect.org/cs/articles?article=everyday_corruption)

contests between competing companies or competing sectors of an industry or, occasionally, competing industries. . . . Many of these battles (eg. over health care reform) continue but have moved into the regulatory process, where different companies, sectors, and industries are seeking rules that advantage them and disadvantage their competitors.”

Reich is arguing that the business of government has become the provision of rules and regulations that favor some over others. In other words, he is describing a completely legal, but involuntary, transfer process promulgated by government. The winners are those who have more clout among legislators. Often they are the ones who can offer the most in campaign contributions. The losers are either the unfortunate competitors of the more influential companies, or the taxpayers who must provide funding for the subsidies that are provided, or consumers who pay higher prices due to the taxes or regulations applied. In titling his article “Everyday Corruption,” Reich is indicating the unsavory nature of the political process, in which increasingly objectionable involuntary transfers are the name of the game.

The same process is playing out with respect to financial sector reform. Greed has been implicated as the source of the problem, but as we should now see, greed is just a smokescreen. Regulatory reform is imminent because there is a demand for something to be done and an expectation that government must both fix the current problems and implement changes that will avert a similar crisis in the future. Unfortunately, no one quite knows how to do that. Nonetheless, lack of knowledge about what to do won't prevent changes from being made. That's because there are plenty of influential organizations standing in the wings with suggestions. And while all of these suggestions will be presented as being important for the national interest, more often than not, the changes will be particularly helpful to the proposing organization itself.

Or, what is even more likely, good ideas for regulatory reform will be paired with other regulatory changes that serve particular corporate interests. This is one of the reasons so many pieces of legislation are so long these days; to buy political support good legislative changes must be appended with special favors to the most powerful interests. It is no wonder that, after decades of rule writing like this, our regulatory system is a twisted web that requires companies to hire dedicated consultants to untangle.

Conclusion

That greed does play a role in all of this, there should be no doubt. But demonizing greed will not solve any problems. Rules and regulations can and should be used to help make the financial system, and the economic system more generally, function more smoothly. But in determining the appropriate policies we should be looking more carefully at whether the policy inspires the appropriate type of greed.

In other words, let's try to make sure policies encourage voluntary exchange and the market competition that arises from that. That requires strong laws that protect private property and the enforcement of contracts while avoiding rules and regulations that give a competitive edge to this firm, or that industry. Let's also seek policies that proscribe

fraudulent business activities and give agencies the resources needed to enforce these policies.

Let's also stop demonizing greed per se. Greed is absolutely necessary to inspire the innovative productive capacities of every nation's people. But greed also inspires an awful lot of what's wrong in the world today. Thus, when we demonize greed in general, although the intent is well meaning, we are at the same time demonizing activities and outcomes that we should be encouraging instead and that makes it counterproductive. Instead we need more people to understand that there is good greed and bad greed and we need to develop more tools to distinguish between the two. Some ideas on how to do that can be found in a newly published book by the author titled, *A Moderate Compromise: Economic Policy Choice in an Era of Globalization*," published by Palgrave McMillan.