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On Politics and Markets

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Lizard Brains, Market Meltdowns and the Welfare State

Dodd-Frank did not fix all of the conditions that led to the financial crisis, nor did the financial crisis end. With the United States and Europe still attempting to extricate themselves from their economic troubles, pronouncements that the crisis is something in the past are rooted in delusion, despite the good news that emerges from time to time in the form of better than expected corporate earnings, recovering housing markets, and climbing equity market indices – all welcome, for sure, but not enough to signal that we are out of the woods.

Dodd-Frank was supposed to be a large step in the direction of fixing the *industry* that had a large role in creating the precarious macroeconomic conditions that still obtain, and indeed it was. However, lobbyists are hard at work – and have been for some time – gelding that law, by weakening prescribed agency rulemaking. The lobbyists are being sent, of course, by the industry itself. Elements of Dodd-Frank that have the most teeth, such as the Volcker Rule (named after former Fed Chairman, **Paul Volcker**), have received the bulk of lobbyist attention. Of course, the problem is not the lobbyists per se, but those who keep sending them. Lobbyists are just agents, after all.

In a recent op-ed piece, published in New York's *Newsday* (March 19, 2012), in response to **Greg Smith's** departure from Goldman Sachs, I warned that regulation alone is insufficient to reform financial services (financial "services" being, largely, a misnomer to begin with, as the real objective of the industry has become, unfortunately, financial "extraction"). Here is some of what I wrote:

> Wall Street needs to enter the painful process of reinvention. Unfortunately, it's hard to see how this will happen without enlightened leadership from within, and new firms with new models of service that are willing to earn less in exchange for client trust, loyalty and stability. We have a "green revolution" under way in energy and sustainability. It's time for a similar cultural revolution on Wall Street.

The operative word is "cultural." But why isn't calling for sweeping cultural change in the financial services industry a non-starter? To answer that question, I need to get a bit philosophical and also call up some basic psychology. For there is an assumption that what makes the call for cultural change pie-in-the-sky is the irresistible power of money, which supposedly trumps all other considerations, all of the time. There is something just as powerful as money, however, and all who are calling for more and more intricate regulatory reforms are missing it, and so they are only scratching the surface.

So here's the philosophical and psychological sidebar: Folks, we're all toast; we're all gonna die. We are all naturally programmed to push that event off for as long as possible. Likewise, we are creatures who are susceptible to suffering. We are, as well, naturally programmed to push suffering as far away as possible. I doubt that many of you who are reading this will want to argue with these two observations, though you may be dubious about what this has to do with the financial crisis.

Much, but not all, of the bad and self-serving conduct we have seen in financial services in recent years has to do with these two primal concerns – concerns about death and suffering, but mostly about suffering. The "lizard brain" calculation (and we are all driven in large part by our lizard brains, our amygdalas (which are the centers of fear conditioning) is that the more money you have the more effective you will be at staving off dire events. Lots of money helps greatly to assure that food, clothing, shelter, and status will never be a problem (status is important in evolutionary and socio-biological theories, as it was for social and economic theorists, including **Jean-Jacques Rousseau**, **Adam Smith**, **Karl Marx**, **John Maynard Keynes** and **John Kenneth Galbraith** (who gave us *The Affluent Society* and the concept of "the dependence effect"). Lots of money means you will be able to buy the best health care that is available for you and for those you love. Beyond avoiding death and suffering, lots of money means that you can position yourself more effectively to enjoy life's pleasures, and lots of money helps to assure that your children and grandchildren will be in the same position.

We have been treated to a raft of explanations for the current crisis – stories about "black swans," the securitization of mortgages, moral hazard, institutions that were and are too big to fail, the peddle of opaque and misunderstood derivatives, etc. But underneath all of this, could something more basic be the real driving force? Could it be that it is not greed *simpliciter* that has taken over, but rather its first cousin, *hoarding*, a compulsion driven more by fear than by the pleasures that attend market success?

Wall Street was not always as bad as it is now, from an ethical point of view, although it has always had its scandals. It was not so long ago that Wall Street bankers' compensation packages could be characterized as merely handsome, rather than stratospheric. This is not to say that Wall Street was ever a bastion for saints. But since the 1980s, when I got my first meager jobs on Wall Street, something has changed. A number of things contributed to a shift on the continuum of service – the poles of which are pure commitment to clients and customers, on the one end, and pure commitment to self-interest, on the other end – such that Wall Street increasingly became a place where one went to take care of one's own financial goals, as quickly as possible, even if it meant betrayal of the firm that employed you. This fact is one of the strands in the "flaw" **Alan Greenspan** admitted to in Congressional testimony in October of 2009.

The shift to the selfish side of the continuum of service coincides in time, at least arguably, with constant talk about the opportunities and, more to the point, *threats* of globalization, of international terrorism, dire warnings about a $60 trillion structural deficit, a widening wealth gap, two simultaneous wars, the onset of the AIDS epidemic, fears about the collapse of the public health care system, the dwindling of pensions and talk of go-it-alone retirement planning, the world-changing specter of global warming, scandal after scandal in what were thought to be unshakable American institutions, the decline of America's dominance, a stratospheric national debt, budget deficits in the trillions of dollars, increasing focus on short-term performance as regards corporate p & l statements and balance sheets, and a global network of instant communication that serves up the tales of woe day in and day out.

That's quite a lot for average people to digest, and quite a lot for even the well-placed economic elites to digest. The well-placed elites, however, can *do* something about all of these threats and hazards. My thesis is that they, wittingly or subconsciously, drew, and are continuing to draw, a single conclusion – the world is more dangerous than ever, and not merely because of political and military threats, but also because of a raft of threats of various kinds, all heading into their lives on various vectors, all at once.

The bankers, the securitizers of mortgages, the inept or duped home buyers, the purchasers of the dream that derivatives will protect their towns or cities or portfolios from financial ruin, the businesspeople who were asked to plan the futures of their firms in a fog of global threats and uncertainty, have all lived through (are *living* through) all of the preceding. The conclusion that what happened, that what caused the crisis we're still living through, is simply run-of-the-mill "greed," is shallow. There is more to all of this than mere greed and missing pieces of regulation. Fear, severe angst, must be factored into the analysis as well. I would argue that what we have been witnessing for the past decade, a decade of fear and uncertainty, is a combination of simple greed *and* fear-based hoarding of astronomical proportions among those elites who were and are well-positioned to do so. Fear, of course, has a tendency to push standards and ethics to the side, as the lizard brain kicks in and drives us to self-protection above all else. Ethics and standards are often the first casualties of fear. They become "luxuries," trite considerations that are more appropriate for less threatening times.

Capitalism is arguably one of the best engines for economic growth and wealth creation that the world has ever known. Its flaws are well known, too. Its focus on personal liberties and its near relentless desire for extrication from government intervention in the markets, and the corporate cultures that celebrate both, also trumpet a robust individualism and suspicion toward the welfare state. **Ronald Reagan**, along with **Margaret Thatcher** in Britain, ushered in an age in which the welfare state – and so the *security* it provides – would come under constant siege. But, ironically, the welfare state exists to combat fear. But its survival requires a potent sense of *political community*, a sense that we are part of a social and political compact, and so have a political and moral obligation to assure that, with few exceptions, all who are parties to the compact will never suffer extreme want, or lack access to the social goods that can transform lives. The attack on the welfare state was, then, an attack on the bonds of political community – an erosion of the sense of community, of a sense of "us," that markets as such couldn't care less about.

Conservatives and libertarians are right to warn us about the potential for citizens' dependency on a welfare state that has become too robust. Though I label myself neither a conservative, nor a libertarian, I share those concerns. Yet it is the welfare state, in some form, that expresses the "we" of the political community; it guarantees fellow citizens that they will not be left on their own in the face of life's misfortunes – the loss of one's health, of one's income, of one's security, of one's property at the hands of nature or markets.

The emphasis that is placed on individualism and market freedom by many conservatives and market libertarians has also placed a great deal of strain on the notion that we are "all in this together" – on the notion that we are part of a political community in which we owe one another, at a minimum, protection from the worse that can befall us, sometimes *because of* business cycles and what **Joseph Schumpeter** called "creative destruction." In a true political community, members are not left to the mercies of markets because, as is the case with disease and natural disasters, the markets show no mercy. Lauding the capitalist engine – the relatively free market – without frequent reference to the political compact leads to a dangerously skewed view of the world. Market ideology tells us that we are on our own, that our security is entirely up to us and our performance in the market. In times of crisis or heightened fear, says market ideology, we must turn to our own resources and acumen. It is "every man for himself." The lizard brain takes over, and the hunt is on.

Those who fashioned the modern welfare state in the West did so in response not only to the natural calamities that befall all of us (we need only think of Hurricane Sandy), but also because of the carnage that markets sometimes create. The central notion of the welfare state, and of politics when it is working as it should, is that people, not markets, come first. Markets are merely tools, albeit critical tools, for the creation of social welfare. When all of the priority and emphasis are placed on markets, and when attention to the political compact is thin, bad things tend to happen. Much of what market libertarians and especially conservatives don't want – rippling disruptions that impact and devastate ordinary people's lives – are often the result of a lopsided commitment to markets and market ideology. It is a fiction that markets only produce "the good." They sometime produce great harms. The skewed priority placed upon free markets by libertarians caused trillions of dollars of real wealth to evaporate in a matter of weeks at the height of the credit crisis, and the international economy was nearly destroyed. It took the quick interventions of governments and quasi-government organs to stave off disaster. All of the individualism that is supposed to lead to innovation and raise all boats was undone by capitalism's own instabilities, magnified in an era of uncertainty and fear.

Just as regulations such as Dodd-Frank were crafted to address some of the worst efficient causes of the current crisis, what must be remembered is that the fears that may have led to the level of self-dealing that pervaded the system are not only still present, but are magnified. They have been magnified, ironically, because of the crisis itself; there are now even *more* lizard brain incentives to take care of oneself, more reasons than ever to self-deal – that is, from the lizard brain's point of view.

Regardless of the new regulations that are coming on line, there will always be new ways to game the system. It is naïve to think otherwise. And the system will be gamed, unless, of course, we start to have a conversation about political community, about citizenship, about the need to assure that our greatest fears will not be permitted to come to pass because our neighbors, our country, will not permit them to. We need a new conversation about the place of the welfare state in the contemporary world, and we need to admit that all of the various government interventions we are witnessing – totaling into the trillions of Dollars and Euros – are in fact rooted in the very notion of the welfare state, whether certain market participants and libertarians like it or not.

We need to rebalance our emphasis on markets against the need for stability in civil society. This will take no more than recalling that the purpose of markets is the service of people. Ideological commitments to market values must become a thing of the past. It is time for an era of pragmatism rather than ideology as regards markets. It is true that to a large degree markets function best when not fettered by pointless public interference, but regulating credit default swaps, mortgage brokers, and commercial banks does not constitute pointless public interference, regardless of what the lobbyists, and their principals, say.

We need a long, national conversation about civics, about what we owe to each other, about how we can take some of the fear out of our lives, and calm the lizard brain's hoarding impulses. Dodd-Frank and other legal initiatives in Europe and elsewhere are law, but law is no more than coercion. What we need now the law alone cannot provide. We need corporate and political leaders who are wise, who operate from sagacity rather than from raw calculation alone. Wisdom is not taught in business schools or in Wall Street internships, but it can emerge from sharing in a sustained national conversation about markets and the meaning of civic commitment.

Talking about civics and citizenship is sloppy and imprecise – not the bailiwick of executives and corporate managers. But being human, being citizens, is sloppy and imprecise. Self-government is sloppy and imprecise. Messy non-market values and goals are always part of the discussion. This is why formulating the solutions to the current crisis cannot be left to executives and managers alone, or to regulators alone, or to market participants as such. That said, since corporate executives and managers are our fellow citizens, too, it would be good of them to do their part. They might start by calling back their lobbyists, and to think instead of what is good for the country and of the system that has afforded them, and their firms and stakeholders, so much.

I STARTED OFF BY SUGGESTING that the desire for money has its counterpoint, that there is something more powerful than money. But just what is it? For many, it is the nagging feeling that one is a traitor to the very country and the very system that one claims to hold so dear. I think that nagging feeling is enough to make many market participants – most of whom are decent human beings – take a long, hard look in the mirror, and ask themselves whether the person looking back is someone they can live with.

Can it be that after all the libertarian rhetoric about the “interference” of government in markets, about overdone social safety nets, about the “slide” on the “slippery slope” into a “European-style welfare state,” that the need for a robust welfare state is now clearer than ever? Are we finally at a point at which we can have a different conversation about markets and the role of nation-states, only recently thought to be going the way of the dinosaur? I believe the time is ripe for just such a conversation. And we’d better get to it.
