The Ethical Errors of Economists and the Elite
and the Exacerbation of the Housing Bubble Collapse

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It can be hard in school to really understand certain historical events. You might think to yourself "How can people be so evil?" or "How did the people in charge let this happen?" or "I wonder what it would have been like to live through that time and suffer with everyone else." One such event was The Great Depression. The images of long lines outside soup kitchens, men holding signs begging for jobs, and stories of women making clothing out of burlap sacks leave a lasting impression. While I was not yet old enough to truly understand the scale and scope of the effects of The Great Recession, I am very glad that the fallout did not reach the levels seen in The Great Depression. It is unthinkable that such an event should happen once and words cannot describe how it is to have something happen twice. In order to prevent such an event from happening a third time we must ask like I asked before, "How did the people in charge let this happen?" How could ethical behavior in business have prevented The Great Recession from happening?

Background

A Brief Overview

Beginning in December 2007 and officially ending in June 2009, The Great Recession was the longest recession since World War II, although there is a good chance that the COVID-19 recession will reach similar levels of impact, albeit in different areas (Rich, 2013). GDP fell 4.3 percent from its high point in 2007Q4 to its lowest point in 2009Q2 (Rich, 2013). The unemployment rate grew even more than the GDP fell, at a peak of 10 percent in October 2009, nearly four months after the official end of the recession (Rich, 2013). People in all tax brackets felt the effects of the Recession with the S&P 500 falling a maximum of 57 percent, home prices falling an average of 30 percent, and overall US household net worth falling 20 percent (Rich, 2013).

Throughout the crisis, the Federal Reserve implemented a number of countermeasures such as decreasing the federal funds rate to zero or just above, down from about five and a quarter percent (Rich, 2013). Policymakers also enacted the Economic Stimulus Act of 2008 and the American Recovery and Reinvestment Act of 2009 which aimed for fiscal stimulus through government spending and tax cuts (Rich, 2013).

Ultimately, even four years out of the Recession, the unemployment rate still had not returned to its earlier rate of 5 percent and market recovery was still slow but steady (Rich, 2013). The Fed continues to change its policies to try and find the perfect mix to return the economy and to reflect current economic and political theory (Rich, 2013).

Causes

The most commonly cited and most major cause of The Great Recession was a bursting housing bubble in the United States (Duignan, 2019). Since 2001, lenders had decreased the prime rate, the rate charged to the lowest-risk customers, which allowed the banks to lend at lower rates to higher-risk customers who normally would not have qualified for mortgage loans (Duignan, 2019). Thus, demand for homes increased dramatically which increased home prices until 2005, when home prices began to decline along with declining demand for housing (Duignan, 2019). Many subprime borrowers held mortgages with adjustable rates which increased alongside the aforementioned changes in housing prices and demand (Duignan, 2019). These adjustable rates rose to such levels that the borrowers were no longer able to afford their mortgage payments and their mortgage loans often became worth more than the homes they were taken out to pay for (Duignan, 2019).

All of this spelled trouble for the banks. So much of their assets were tied up in these subprime loans and bonds and less-risky debts such as mortgage-backed securities and other forms of consumer debt (Duignan, 2019). All of these debts were difficult to track and banks began to doubt each other's financial statuses (Duignan, 2019). This mistrust in each other lead to an interbank credit freeze which hampered banks' ability to lend to even financially secure customers, including businesses (Duignan, 2019). To balance their budgets, businesses then were forced to reduce expenses leading to job losses (Duignan, 2019). This began a cycle where people had less money to spend on goods so the companies producing those goods laid off more people and so on (Duignan, 2019). Big businesses and even large and prestigious banks and investment firms began to apply for government bailouts or merged with companies in better shape (Duignan, 2019). Some companies such as General Motors and Chrysler declared bankruptcy and accepted partial government ownership as part of their bailout packages (Duignan, 2019). Consumer confidence waivered and many households decreased spending to save in anticipation of tougher times ahead, which, in turn, dealt another blow to the health of businesses (Duignan, 2019).

Literature Review

In *Consequences of Economic Downturn: Beyond the Usual Economics*, multiple economists discuss the ethical responsibilities of economists and the array of factors that lead to The Great Recession (Barrett, 2011). Economists have no professional ethical code that they should act in the best interest of the public and have opposed doing so (Barrett, 2011). Thus, even though many economists could have foreseen the recession that would follow the popping of the housing bubble, they were under no obligation to do so (Barrett, 2011). Some economists that do want ethical oversight argue in favor of a set of hard and fast rules while others would like to see the formation of a field dedicated to economic ethics, similar to that of medical ethics (Barrett, 2011). Other economists pushed back against the ability of large corporations to take on massive risks and then take government bailouts if the risks do not pan out in their favor, ultimately dumping their fiscal obligations onto the taxpayer (Barrett, 2011). Some authors ponder over what power the average American has to prevent such events from happening and how they can do little to support the economy during a downturn (Barrett, 2011).

Rather than study business ethics from a business viewpoint, in writing for the Stanford Encyclopedia of Philosophy, Jeffrey Moriarty examines business ethics from an academic standpoint. One of the first and most important questions Moriarty poses is whether or not firms as a whole can be a moral agent or if they are simply an aggregate of the individuals that make up the firm. Although many people will reference a firm in such a way as to assign it moral agency ("Walmart treats its employees poorly"), this could be a shorthand way of referring to the individuals that comprise the managing portions of the Walmart company (Moriarty, 2021). Some may argue that because firms have internal structure, even though it is individuals that carry out the actions and decisions, they are bound to this structure and so the firm has moral agency and responsibility (Moriarty, 2021). Others argue that firms are not moral agents because they cannot pursue their own happiness or because without the decisions of individual members, nothing would get done (Moriarty, 2021). Even more people argue on the basis of who bears the responsibility of decision making, whether or not firms can act with intention, or whether or not firms have the emotional foundation to understand right from wrong and feel emotion (Moriarty, 2021). One more important question that Moriarty poses is whether or not it matters if the firm is held accountable or the individuals that make decisions are held accountable so long as some entity is held accountable.

Author's Note: Sorry about the page skips here. Word insisted on only allowing the section header on this page, so I moved the whole thing to the next page. Thank you for understanding.

Discussion

I think that no matter what stance you take on business ethics, if the firm or the individuals are responsible, or if economists have a duty to warn of impending economic disaster, it is clear that at least one person or firm dropped the ball and did not uphold the moral standard that is expected of them. While I do agree that at the most base level, individuals are responsible for the conditions that lead to The Great Recession, it is important to remember that as Moriarty suggested, firms can have an internal structure that limits the behavior of individuals. Even today, the idea that firms or laws can have inherent bias is a polarizing topic.

The banks that lowered the mortgage interest rates and lent out to high-risk borrowers and then raised the interest rates are clearly responsible. Without those deals being made, the collapse may have still happened but so many people that lost their homes would not have. Of course, they would not have lost their homes because they would not have been able to buy one, but that is a discussion for another time. But why did those banks make those loans? Who benefitted? Bank executives and shareholders are the ones who benefitted, specifically the shareholders who had so many shares that what they did lose was worth less than the shares they owned. One could argue that the shareholders have little power over the operation of the businesses they own shares of, but I cannot believe that if all the shareholders of a specific company agreed that morals come before money, that the business would not follow suit. This is, of course, because the business is beholden to the wishes of the shareholders.

At this point, it may seem easier to blame society or capitalism for placing so much importance on the value of money, but that does not negate the fact that some people and some companies put profits first and either did not think through the consequences of their actions or, even worse, did think their actions through and did not care what the consequences were.

Conclusion

Up until the COVID-19 pandemic, The Great Recession was the largest recession in most peoples' living memory. Many people were left destitute, having lost their homes and their jobs, and did not care who they were angry with so long as there was a scapegoat to be angry at. That scapegoat could be the economists who foresaw the housing bubble collapse and chose not to speak out. Those same economists do not have a professional obligation through a code of ethics. Should they have a code of ethics? Or does responsibility lie with the banks themselves or the people that make up the bank employees or even the bank shareholders? No matter who responsibility does lie with, and it is clear that responsibility is shared among many, many people, there were clear moral and ethical decisions that were made and the decisions that were made were the wrong ones.

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