Rotten Apples or a Rotting Barrel: How Not to Understand the Current Financial Crisis

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What caused the financial crisis? Certain observers blame poor choices by victims and irresponsible decision-making by market actors – and say more regulation isn’t the answer because the problem is not the unregulated market. This excuse is often heard after organizational failures, and it misses the point by accusing the bad apples and not the rotting barrel.

Holman Jenkins Jr. writes in the December 17 Wall Street Journal that investors with Madoff were incompetent consumers. They failed to behave as the responsible and rational actors economic theory assumes they will be; they trusted rather than investigated the person with whom they invested.

The daily reports about hedge funds earning reliable profits of 20 to 30 percent annually were irrelevant and did not feed the fraud. The front page of the December 18 New York Times quotes Professor Lucian Bebchuk of Harvard Law School as saying that Merrill Lynch managers were “responding to distorted incentives.” Those are the very same incentives many law and economic scholars claim are the only ground of rational action. If the unconstrained pursuit of self-interest and economic reward that has led to the complete financialization of all production, distribution, and management turns out to be just one big global Ponzi scheme, it is not, according to neo-liberal ideologues, a flaw in the theory of the market but simply the result of bad or incompetent market actors.

Should we remember that the theory of the market – as the most efficient mechanism for coordinating action – rests on the assumption that bad actions will nonetheless lead to good outcomes?

Crises of corporate and professional responsibility have been endemic to American capitalism, and if the current financial crisis is of an unprecedented magnitude, it is different only in degree but unfortunately not in form.

With each chapter – from the robber barons of the nineteenth century, the Tea Pot Dome scandals and the stock market crash of 1920s, through Watergate, the Savings and Loan crisis, and Iran Contra in the 1970s and ’80s, to Enron and World Com in the 1990s, to the current financial disaster – the response has been unimaginatively the same: some few weak or greedy, uninformed or misguided individuals made poor choices. Those bad apples made the barrel rot.

Just as we have the American myth of Horatio Alger battling all odds to lift himself up by his own bootstraps, we have a companion myth concerning poor choices and ethical lapses. The stories of Enron, the drug trials for Actonel, and the Schon affair at Bell Labs, for example, have already been narrated as stories of a few rotten apples in basically good barrels. In a similar manner, we will soon see more and more stories about Merrill Lynch, Citigroup, AIG, and General Motors describing how one or another person made a bad
decision or acted unwisely. We are unlikely to read stories about rotting barrels, only about rotten apples.

The story about a rotting barrel would require an analysis of how the progeny of Milton Friedman and Friedrich Hayek propagated modern *laissez-faire* economics and sold it worldwide through the Washington Consensus, the World Bank, and Wall Street, successfully challenging the legitimacy of government (and just about all institutions other than the family) while legitimating a massive transfer of wealth from the working and middle classes to super-rich financiers who eventually rotted in that very same barrel. This less familiar story about a rotting barrel would also require us to ask how the theory of the efficient market managed to justify annual bonuses exceeding the annual profits to shareholders. Might we soon hear a story about how this financial downturn is merely an expected once-a-century readjustment for longer-term capitalist stability? I guess those shareholders – pension and mutual funds, states, banks around the world – were just irresponsible, that is bad consumers, unprepared for this market correction. In other words, because the cause of our crisis, in the popular account, is not a rotten barrel but a few bad apples, we need not look any further to explain how this financial pyramid imploded.

I keep thinking, however, that if the apples keep rotting, there must be something wrong with the way they are grown or with the barrel.

More than 60 years ago, the sociologist Edwin Sutherland published his much lauded work on white-collar crime in which he observed that American corporations constituted the largest category of criminal recidivists. This counter-intuitive observation illustrated Sutherland’s theory in which he described criminal behavior as normal learned behavior in subcultures where there is an excess of circulating definitions favorable to violation of norms or law over definitions unfavorable to the violation of law. He called this the principle of differential association. If we want to understand how the barrel rots, Sutherland suggested, we must look to the discourses and interactions that constructed and organize the barrel. The principal lesson Sutherland offers is that all behavior, deviant as well as normative, is learned in interaction with others. That learning includes the motivations, drives and rationalizations, as well as techniques, which can be complex, especially in financial transactions. Sutherland’s work emphasized the importance of *cultural context and social organization* rather than exclusive focus on individual choice making. In other words, while we might want to acknowledge human agency and decision-making at the heart of economic or any other social action, we blind ourselves to the structure of those choices – incentives and content – if we focus too closely on the individual and ignore the larger culturally validated opportunities and motives that channel that choice-making activity.

Rather than thinking about this financial crisis as the consequence of an episode or series of problematic individuals, organizations, or professions, we might think about it as the outcome of learned behavior. We might then ask how our culture supports or challenges different kinds of behavior, how that culture is learned, and what are its lessons and messages. Then, we might imagine moving from a narrative of a few bad apples, or many bad apples, to a story about how the apples are grown, how they enter the barrel, and finally how different organizations of the barrel – free markets or regulated markets, effective government or privatized governance, shareholder power or corporate autonomy – might keep them fresh or encourage rot.