

The Economic Crisis and the Crisis of Character

As I write, the world is in the midst of the greatest financial crisis since the Great Depression of the 1930s. Within the last few months, some of the oldest and best-known names in American finance, such as Bear Stearns and Lehman Brothers, have evaporated, while bank failures are at their highest level in decades.

There is also a deepening economic crisis, which looks like one of the worst in recent memory. The stock markets of the world are down about 40 percent compared to a year ago, suggesting that investors believe economic activity will decline sharply; in the meantime, about two million jobs have been lost in the United States in the last few months.

A financial crash is not a natural disaster like a hurricane, volcano or tsunami—it is a totally human phenomenon brought about by the free choices of human beings.

The Torah commands us, “choose life”—it demands that we employ our free will in a responsible way, and instructs us in the proper way to make choices. Let us take a look at the lessons we can find in our tradition

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about how decisions were, and should have been, made in the economic environment that preceded the meltdown.

Economists mostly agree that the source of the artificial boom that recently went bust was a real estate bubble. A “bubble” means that asset prices rise not because of fundamental valuations on the part of buyers but merely because of expectations of future price rises—a cycle that obviously cannot last forever. This particular bubble was fueled in large measure by “sub-prime” mortgages, mortgages granted to borrowers with high default risk. Extending credit to these individuals for the first time greatly increased the demand for housing, thus pushing prices up; the cycle of rising prices encouraged lenders to extend even more risky loans, confident that the value of the collateral would remain safe. When the bubble burst, as all bubbles do, homeowners and then lenders were left insolvent. From there, the crisis spread to other lenders who lent not to high-risk borrowers, but rather to the precarious financial institutions who lent to them.

What went wrong? One possible candidate for fault is simple fraud. In a fascinating interview in *Time Magazine*, Rabbi Aaron Levine, chair of the

economics department at Yeshiva University, discussed the various ways in which self-serving advice and misleading sales tactics contributed to the crisis.

Almost the entire chain of transactors in the mortgage crisis is guilty: predatory brokers for not alerting working-class borrowers to the fine print; middle-men selling mortgage debt to investment banks sliced and diced into “tranches” that obscure their riskiness; bankers who used hard-to-fathom financial instruments that leave ultimate responsibility for a loan a mystery even to experts (October 10, 2008).

Rabbi Levine explains how all of these abuses could have been prevented by adherence to the letter and spirit of various *halachot*, including the prohibition against self-serving advice (“*lifnei iver*”), the requirement to disclose defects and so on. These legal obligations embody universal moral prescriptions, which, if followed, could have done much to prevent the crisis.

Many experts agree that carelessness with “other people’s money” had

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an important role in the market meltdown. For example, former Federal Reserve Chairman Alan Greenspan commented that regulations should be changed to forbid banks from selling mortgages unless they bear some of the risk. However, this explanation is only partial. The fact is that most of the major players who went bust in this bubble were extremely sophisti-

So it seems that the more profound ethical problem behind the crisis is that people were defrauding themselves. They were completely convinced that housing prices could never go down; the basic risk management policies that are at the foundations of financial management were severely neglected. What responsibility do investors bear for this misjudgment?

However, it is possible to fault them for not adequately *considering* the risk. It's true that high finance is a risky business, and that you win some and lose some. But the financial mismanagement in the latest crisis went beyond this. Risk management is the foundation of the financial industry,

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cated individuals and institutions that, in the end, lost their *own* money. The chairmen of Bear Stearns and of Lehman Brothers each lost hundreds of millions of dollars of their own wealth in the meltdown; banking giant Citibank lost billions of its own dollars on bad investments.

It's unfair to fault investors for not *predicting* the crash. It's true that many doomsayers correctly predicted a crash months or years in advance, but, in their defense, investors can point out that doomsayers correctly predicted the last three downturns that occurred—plus the last five that never materialized.



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Soon after I finished writing this article, news broke of Bernard Madoff's historic 50-billion-dollar swindle and the many Jewish individuals and institutions victimized by it. While I feel genuinely sorry for the many upright individuals and worthy institutions that were taken in by this scheme, ultimately I cannot escape the feeling that this too was a consequence of wishful thinking and of paying attention to only those messages we want to hear. The warning signs were numerous: more than a few people and institutions shunned Madoff's firm when they noticed the bizarre lack of electronic account access (which complicates forgery); the unprecedented string of positive returns (as long as six years without a losing month); the fact that each investor saw trades that, while individually plausible, could not have been duplicated on anywhere near the known scale of his total business (the very same clue that blew open the scheme of Charles Ponzi almost ninety years ago); Madoff's insistence on having funds deposited through his firm and the tell-tale use of a tiny obscure accounting firm with a single active accountant to audit a financial empire managing tens of billions of dollars—an obviously impossible task.

Of course, it was reassuring to think that Madoff, with his charm and mystique, his remarkable track record and his high standing in the Jewish and financial communities, was a wonder worker. The fact that so many prominent persons and institutions trusted him led people to let down their guard—just as the general euphoria about rising real estate prices led everyone to assume they could never go down.

The Talmud (*Bava Metzia* 75b) tells a fascinating story of Ravina and Rav Ashi, the redactors of the Babylonian Talmud and certainly among the greatest sages in our history. After the Talmud tells us that it is improper to lend money without witnesses, since it may tempt the lender into denying the loan, we learn that Rav Ashi decided to test Ravina. He sent a messenger asking for an small but urgent loan just a short time before Shabbat, when Ravina would be pressed for time. Ravina was not taken in; he insisted that he would make the loan only if Rav Ashi brought witnesses, and a deed to boot. The message we can take from this story is that no person, no matter how great his stature in the community, should be immune from accepted standards of transparency and oversight.

yet the risk models used to evaluate default risk were sloppy and unprofessional. The financial press reports that risk models used by insurer AIG completely ignored certain categories of risk, and that the risk model at Citibank literally did not include the possibility of a nation-wide housing downturn. The verdict is in: top executives just did not want to hear the bad news.

I see an instructive parallel to these events in the dramatic confrontation between the prophet Yirmiyah and the false prophet Chananyah. King Tzidkiyah plans to rebel against the Babylonian King Nevuchadnezzar, who at that time dominated the Land of Israel

and the entire region. Yirmiyah warns him repeatedly that such a rebellion would be defeated and would result in disastrous retribution from Nevuchadnezzar; yet the prophet Chananyah prophesies with equal assurance that the revolt would be a success—exactly what Tzidkiyah wanted to hear.

And it happened in that year, in the beginning of the reign of Tzidkiyah king of Yehudah, in the fourth year in the fifth month, Chananyah the son of Azzur, the prophet from Givon, said to [Yirmiyah] in the House of the Lord before the priests and all the people, saying: "So said the Lord of Hosts, the God of Israel, saying: 'I have broken the yoke of the king of Babylon. In another two years, I

will restore to this place all the vessels of the House of the Lord, that Nevuchadnezzar the king of Babylon has taken from this place and brought to Babylon. And Yechanyah the son of Yehoyakim the king of Yehudah and all the exile of Yehudah who came to Babylon, I will restore to this place,' says the Lord, 'for I will break the yoke of the king of Babylon'" (Yirmiyah 28:1-4).

Yirmiyah scolds Chananyah, reminding him that the true role of the prophet is to tell things as they are, not to flatter people with what they want to hear:

But, hear now the word that I speak in your ears and in the ears of all the people. The prophets who were before me and before you forever, they prophesied concerning many lands and great kingdoms for war and for evil and for pestilence. The prophet who would prophesy for peace, when the word of the prophet would come, the prophet whom the Lord had truly sent would be known (Yirmiyah 28:7-9).

Of course, it is not the prophet's job to predict war and evil and pestilence! Rather, Yirmiyah explains that the main role of a prophet is not to predict the future but rather to bring the people to repentance; if necessary, to do so by warning them of the potential dangers of their ungodly behavior. The Malbim comments:

Most of the prophets prophesied prophecies of retribution, because the purpose of the prophet's mission is to inform the people of the harm that will befall them so that they will turn in repentance, and this is why Hashem sends a prophet, but not to augur good events in the near future.

Yet Chananyah's words do not seem designed to bring about any change in the people's conduct.

Today we read this passage with self-righteous hindsight. How could the people, and the king, have credited the despicable false prophet Chananyah over the righteous Yirmiyah, one of our greatest prophets? But in fact the situation was not so simple for contemporary observers. The Gemara tells us in *Sanhedrin* (90a) that Chananyah was originally a true prophet; only later, as in the above passage, did he begin to declare prophecies never entrusted to him by

Hashem. The Jews of that time had no guarantee that Yirmiyah was right and Chananyah wrong.

Still, we can question King Tzidkiyah's judgment on two counts. First, even if he wasn't sure that Yirmiyah was right, he should have at least taken his position into account. The rebellion against Nevuchadnezzar was so fraught with uncertainty, and the consequence of failure so disastrous, that anything short of near certainty should have been enough to deter the king. Second, given that the prophet's job is not to predict the future but rather to inspire proper behavior, Tzidkiyah should have been at least a bit suspicious of Chananyah's triumphant predictions.

The Book of Kings describes Tzidkiyah as a wicked king: "And he did evil in the eyes of Hashem" (II Melachim 24:19). Yet the picture presented by Tanach is more than of a weak king—it is of a person of weak character. We see that in the presence of Yirmiyah, Tzidkiyah acknowledged his stature, gave him credence and had mercy on him. However, he explains that he is unable to stand up to the nobles:

And Tzidkiyah said to Yirmiyah, "Let no man know of these words, and you shall not die. And when the princes hear that I spoke with you, and they come to you and say to you 'Tell us now what you spoke to the king, do not conceal from us and we will not put you to death, and what did the king speak to you?' You shall say to them, 'I presented

He, sought to return the entire world to primordial chaos in the generation of Tzidkiyah; then He looked at Tzidkiyah and His mind was put at ease." Why, then, does Sefer Yirmiyah describe him as wicked? Because "he was able to protest, yet did not protest" (*Sanhedrin* 103a). An ordinary person of good behavior, whose only sin is failing to stand up to the evil of others, would not be considered wicked. But if you are in a position of leadership and responsibility, if you are the king of Yehudah, then for such a failing you are judged as an evil-doer.

Centuries earlier, we find a remarkably similar story regarding Achav, king of Israel. Achav and Yehoshafat, the king of Yehudah, contemplate making common cause against the army of Aram:



And Yehoshafat said to the king of Israel, "Consult now this day the word of Hashem." And the king of Israel gathered the prophets, about four hundred men, and said to them, "Shall I go

prophesies me good, but only evil, Michaihu ben Yimlah"; and Yehoshafat said, "Let not the king say so" (I Melachim 22:5-8).

Achav could also be described as someone whose main fault was weakness in standing up to evil. While he is described many times as an evil king, the Tanach also gives an explanation for his wickedness: "Achav, who was given over to doing what is evil in the eyes of Hashem, because his wife Izevel incited him" (I Melachim 21:25). Chazal tell us he was worthy of damnation because "he followed the advice of his wife" (*Bava Metzia* 59a). Adjacent to the description of Tzidkiyah in *Sanhedrin* (102b), the Gemara recounts many of Achav's good deeds.

This description tells us something about the shortcomings of those who led our financial institutions into rebellion against the laws of financial prudence. On the whole, they were not

wicked; like Tzidkiyah, who genuinely wanted the good of the people, they genuinely wanted to benefit their companies and customers. But

they were people of weak character; they forgot that the role of risk officers and risk models is to alert managers to serious risks, not to reassure them that everything is fine. Many willfully closed their ears to the prophets of bad news, and couldn't resist the pressure of the "princes" of the marketplace demanding immediate gratification, even at the risk of future disaster. For a normal

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my supplication before the king that he return me not to the house of Yonatan to die there" (Yirmiyah 38:24-26).

A similar picture, of a well-meaning but weak leader, is evident in the Gemara. Chazal tell us that Hashem was pleased with Tzidkiyah's personal conduct: "The Holy One, blessed be

against Ramot Gilad in war, or should I refrain?" And they said to him, "Go up, and God will give it into the hands of the king." And Yehoshafat said, "Isn't there also a prophet of Hashem, that we may ask him?" And the king of Israel said to Yehoshafat, "There is one left to consult of Hashem, but I hate him, for he never

person, such a tendency may merely be an unfortunate weakness. But for a leader, whether of a nation or of a great financial institution, a strong and upright character is an essential trait. Character weakness in these individuals is a serious ethical flaw that must be rectified. ■