A Crisis of Ethic Proportions

By John C. Bogle

I recently received a letter from a Vanguard shareholder who described the global financial crisis as “a crisis of ethical proportions.” Substituting “Ethic” for “epic” is a fine turn of phrase, and it accurately places a heavy responsibility for the meltdown on a broad deterioration in traditional ethical standards.

Commerce, business and finance have hardly been exempt from this trend. Relying on Adam Smith’s “invisible hand,” through which our self-interest advances the interests of society, we have depended on the marketplace and competition to create prosperity and well-being. But self-interest got out of hand. It created a bottom-line society in which success is measured in monetary terms. Dollars became the coin of the new economy in which “there are some things that one simply does not do” to one in which “if everyone else is doing it, I can too.” Business ethics and professional standards were lost in the shuffle.

We must establish a ‘fiduciary society.’

The proximate causes of the crisis are usually said to be easy credit, bankers’ cavalier attitudes toward risk, “securitization” (which severed the traditional link between borrower and lender), the extraordinary leverage built into the financial system by complex derivatives, and the failure of our regulators to do their job. But the larger cause was our failure to recognize the sea change in the nature of capitalism that was occurring right before our eyes. That change was the growth of giant business corporations and giant financial institutions controlled not by their owners in the “ownership society” of yore, but by agents of the owners, which created an “agency society.”

The managers of our public corporations came to place their interests ahead of the interests of their company’s owners. Our money manager agents—who in the U.S. now hold 75% of all shares of public companies—blithely accepted the change. They fostered the crisis with superficial security analysis and research and by ignoring corporate governance issues. They also traded stocks at an unprecedented rate, engaging in a dangerous spree of speculation.

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