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Who Must Pay for the Damage of the Global Financial Crisis?

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In 2009 the President of the UN General Assembly organised an ambitious conference to deal with the effects of the global financial crisis on developing countries. The draft document for the conference called for a coordinated $3 trillion 'Global Stimulus for Restructuring and Survival', intended to 'help address the strains posed by economic downturn on the poor' and 'lay the basis for a new economy based on human needs, human rights and human security'.[1] This bold idea did not survive the final vote. The world's collective governments shied away from the notion of a global stimulus in the adopted resolution, which meekly concluded that 'each country has primary responsibility for its own economic and social development'.[2] The commandingly titled 'Global Plan for Recovery and Relief' adopted by the G-20 in April 2009 was similarly noncommittal about the allocation of responsibility for the costs borne by developing countries. The G-20 is willing to help, of course, but only because 'emerging markets and developing countries ... are also now facing challenges which are adding to the current downturn in the global economy'.[3]

Domestically, a government would be hard-pressed to say that its citizens individually bear primary responsibility for responding to a major crisis. If, for example, a devastating tsunami struck the coast of a US state, the emergency response would be paid for first by the state at large and then by the general American public, acting through the federal government. By and large we believe that our fellow citizens should be rescued when struck by forces beyond their control, at least when this leads to severe deprivation. We encounter even less

resistance when a culprit can be clearly identified as having caused the disaster through his or her recklessness or failure to take adequate care. When a US Congressman insisted that BP ought not to be forced to pay for the costs of cleaning up the Gulf Coast oil spill, the condemnation of his views was immediate and unanimous – of course the responsible party should pay.[4]

We are not alone in likening the global financial crisis to more familiar disasters. The analogies employed include:

- a tsunami (by former US Federal Reserve Chairman Alan Greenspan);[5]
- an ocean tide (by the World Bank);[6]
- an infectious disease (by the International Monetary Fund);[7]
- a shipwreck, generically (by French President Nicolas Sarkozy);[8]
- the sinking of the Titanic, specifically (by Brazilian President Inacio Lula da Silva);[9] and
- a car wreck (by numerous media commentators).[10]

Thinking about these analogies and their aptness in describing the global financial crisis can be illuminating. The different types of analogies imply different established principles for allocating responsibility to absorb the costs of repairing damage. None of these analogies is perfect, of course, but certainly the first three are the least apt. The financial crisis is entirely man-made and could have been prevented.[11] The notion of a shipwreck is less obviously inappropriate. The negligence and arrogance of the Titanic's crew certainly played a crucial role in its sinking. The difference is that the Titanic combined human failure with the challenges of the natural world (in that case an iceberg), whereas the financial crisis was wrought entirely by human behaviour.

However, the notion of a car crash is a more plausible analogy since it involves human agents employing powerful tools that can cause severe deprivation and other harms.[12] In the aftermath of a car crash, we sensibly ask who, if anyone, is at fault. The costs of recovering from the crash – to the driver, his or her vehicle, whom or what the driver hit, and any third parties involved – are then allocated accordingly. In some cases these costs may be beyond the ability of the relevant parties to pay. The question would be whether these costs should be allowed to lie where they fell or be shifted in part or whole to others.

Our object in this chapter is to draw on the analogy of the car crash to bring out the principles that should guide policy-makers in fairly allocating the costs of responding to the financial crisis and the subsequent global recession. We argue that the approach to the allocation of cost for repairing the damage caused by the crisis adopted by the affluent countries is unacceptable for two reasons. First, it fails to take adequate account of the manner in which the negligent and reckless conduct of affluent countries contributed to it. Second, it fails to recognise that when unpredictable, extraordinary events contribute to severe deprivations, the costs of addressing them should be borne partly by those who can pay for them without much difficulty.

The costs of the financial crisis

Before we discuss principles, we need to know what the costs of the financial crisis are. Just how badly have developing countries been harmed? In the early stages of the crisis, many low- and middle-income countries were expected to be left largely unaffected. The weakness and relative lack of global integration of these countries' financial sectors was seen as a kind of blessing in disguise. Being insulated from the global financial system made them less vulnerable to the rapidly worsening crisis. It wouldn't make much difference to the poor if access to the financial instruments of the affluent were curtailed, since the poor weren't able to access them anyway. Sadly this diagnosis turned out to be incorrect. If nothing else, the crisis has taught us a lesson about the interconnectedness of the global economy.

The crisis has been transmitted to developing countries through a number of channels, including reductions in private capital flows, the increased cost of credit and a reduction in the availability of credit, a sharp fall-off in the volume of trade and decreases in remittances. Estimates of the damage have increased significantly over the past year. Early last year the World Bank expected the economies of developing countries other than India and China to have shrunk by 1.6 per cent in 2009.[13] This proved optimistic. The current estimate is a 2.2 per cent contraction. And the growth of China and India, while still fairly rapid, proceeded at a much slower pace than in recent years.[14] Collectively, the recession implies a loss of $750 billion in income for developing countries, including a $50 billion loss to Sub-Saharan Africa.[15] There is much cause for concern even for developing countries with much healthier economies. As one observer noted, the new global recession 'puts development success stories in danger'.[16]

In discussing the costs of the global financial crisis, we will focus our discussion on severe deprivations – shortfalls that people are likely suffer in their health, civic status or standard of living relative to the ordinary needs and requirements (e.g., food, drink, shelter and minimal health protection) of human beings. Our concern is with the cost of mitigating or alleviating severe deprivations that can plausibly be attributed to the global financial crisis. Much more empirical research and a great deal of counterfactual speculation is required before we can make plausible estimates of the magnitude of severe deprivation that can be attributed to the crisis, but it appears to be quite substantial. The International Labour Organization estimates that 35.7 million people have lost their lobs as a result of the crisis; 19.1 million of those were in developing countries.[17] As a result, the incomes of as many as 84 million people have been pushed below $1.25 per day.[18] As affluent consumers slowed their rampant consumption, the volume of global trade dropped correspondingly, by a staggering 14.4 per cent in 2009.[19] The export-driven growth that has alleviated so much poverty in recent years has fallen correspondingly. In February of last year, China's exports were down by 26 per cent year-on-year, and 20 million migrant workers lost their jobs.[20] Cambodia's critical garment industry dropped in value from $250 million to $100 million per month.[21] In Sub-Saharan Africa, per capita income may have declined by as much as 20 per cent.[22] Education spending per primary school student there has fallen by 10 per cent.[23] Predictably, this loss of income by the world's most vulnerable people will produce very significant hardship: a World Bank study predicts that 1.4 to 2.8 million infants will die over the next six years as a result of the financial crisis.[24]

To make things more concrete, we will focus on just one of the ways in which the financial crisis appears to be contributing to severe deprivations. It is creating a financing gap that makes the debts of many countries unserviceable. The World Bank estimates that the collective financing gap for developing countries in 2009 was $690 billion, and forecasts $315 billion for 2010.[25] Countries will have to either sharply reduce consumption in order to bridge the gap or borrow heavily. High debt levels and financing gaps can limit the capacities of countries' governments to provide social services necessary to ensure even a minimally adequate standard of living for their people, and divert resources and energy from the pursuit of short- and long-term strategies that further the well-being of their people. This effect is particularly acute in the poorest countries and is magnified by exchange rate volatility, since poor countries often borrow in foreign currencies.

The buildup of large debts – so-called debt overhang – creates a climate of permanent financial fragility in a country, leaving that country in a financial and economic slump, without domestic revenue to pay for current expenditures. Because of its financial instability, the country is deemed to be high risk from an investment perspective.[26] Creditors demand a higher interest rate on investment finance – if willing to lend at all – since many of them may have substantial outstanding debt claims on the country.[27] Greece has very visibly found itself in this situation. Fortunately for the Greeks, as a member of the European Economic and Monetary Union, their country's collapse necessitated a rescue by other EU members.

Other countries are not so lucky. For developing countries, the collapse of private finance has left many with nowhere to turn but the International Monetary Fund (IMF), which arguably limits the capabilities of their citizens to exercise meaningful control over their policies and institutions.[28] This threat is very serious for countries like Cape Verde, Cote d'Ivoire, Ghana, Nicaragua and Pakistan, which lack the reserves to implement a fiscal stimulus of their own and are already rated as being at medium to high risk on debt sustainability.[29] As a result of the crisis, one or more of these countries may be forced to choose between expenditures on health, education, and security, or its contractually defined debt obligations.

Principles of assistance and rescue

Who should bear the costs of a country's decision to borrow when that country cannot repay its debts without causing severe deprivations among its people? Should they be borne entirely by the government – and ultimately the people – of that country or should they be pushed in whole or in part on to others? For some human-rights and poverty-relief advocates, the answer is simple. They argue that we cannot demand the fulfilment of contractual obligations that will lead to severe deprivations when these costs could easily be borne by others who would not suffer substantially. The debts of the countries at hand will reliably cause severe deprivations, and these debts are tiny relative to the size of the economies of affluent countries and international financial institutions. The total external debt of all low-income countries is $156 billion, or about one-fifth of the $700 billion US stimulus package.[30] (The US stimulus is, in turn, 40 per cent greater than the $507 billion it would allegedly take to bring all 3.08 billion severely poor people above the World Bank's $2.50 per day poverty line.)[31]

The Austrian economist Kunibert Raffer asserts that 'one must not be forced to fulfill contracts if that leads to inhumane distress, endangers one's life or health, or violates human dignity. Civilized laws give unconditional preference to human rights and human dignity'.[32] This view is also endorsed by many, including advocates of the Fair and Transparent Arbitration Process (FTAP), developed by Raffer and modelled on Chapter 9 of the US Bankruptcy Code, which governs the bankruptcy of municipalities. The FTAP would ensure that the basic human rights (somehow understood) of citizens of debtor countries are given higher priority than creditors' rights in the management of debt crises.[33]

Those who favour initiatives that ask for certain costs to be shifted from those who are badly off to those who are relatively well off appeal, in effect, to a duty of assistance. The broad version of this claim is that if agents are able to assist the severely deprived at some not excessive cost, those agents have a responsibility to address the need. On this view, those with access to funds ought to spend them in ways that help those at most risk of suffering severe deprivation. The thought is not to deny that market participants should generally bear the risks of their decisions – no market system could function well without risk – but that certain extremely bad outcomes should not be allowed to stand when they can be averted at relatively small cost. In our context, the provision of assistance should depend on how heavily burdened the population of a country would be in absolute and relative terms were that country to pay its debts or absorb the full burden of its financial losses, and how costly it would be for others to offset the costs that it would otherwise face.

Principles of assistance are widely acknowledged, even while their extent is a matter of heated debate. In 'Famine, Affluence, and Morality', Peter Singer famously argues that affluent people have responsibilities to assist the global poor by alluding to an analogy of a person passing a shallow pond where another individual is about to drown.[34] Just as the former bears a responsibility to save the latter, the affluent have a responsibility to assist the global poor. Singer holds that a plausible principle that would explain our reaction to the pond case, and which would also lead us to recognise our responsibility in the global poverty case, states that 'if it is in your power to prevent something bad from happening, without sacrificing anything nearly as important, it is wrong not to do so'.[35] Singer does not specify what it means to claim that something is *nearly* as important as something else – he leaves it up to his readers to decide on the basis of their intuitions.[36]

Though plausible on its surface, the Singer Assistance Principle (SAP) may seem unreasonably demanding.[37] The problem lies in the assessment of relative costs. One way to think about the notion of relative importance is the following: we judge the importance of A's bearing cost X relative to B's bearing cost Y by imagining how some third party, C, ought to act, all other things being equal. C can choose to prevent either A from bearing X or B from bearing Y, but not both. According to the SAP, if we imagine that C ought to prevent A from bearing X, then X is more important than Y. Fleshing this out, if C is faced with the choice of saving A's life or B's hand, then, all other things being equal, he ought to save A's life. And by implication, this reasoning suggests that if faced with the choice of saving someone's life or losing my hand, I ought to sacrifice my hand – quite a demanding conclusion. The natural reply would be to argue that B's hand is *nearly* as important as A's life, but this claim is hard to sustain. All things being equal, if C is faced with the choice of saving A's life or the hands of B, D, E, F, G and H, it still seems clear that he ought to save A's life. A hand is not nearly as important as a life. When we shift from hypothetical hands to actual people struggling to survive extreme poverty, the SAP seems especially demanding. After all, it has no end point: extreme poverty is vast from the perspective of the individual. Fulfilling the obligation of the SAP to alleviate extreme poverty would easily overwhelm the resources of even the wealthiest individuals.[38] The SAP seems extremely – and indeed implausibly – demanding.[39]

However, there are many other *much* less demanding principles of assistance that would favour shifting the costs of alleviating severe deprivation on to others, and even those who believe that the obligations of the affluent to address poverty and inequality are quite limited affirm some of them. In the midst of describing why the affluent do not have extensive duties of justice to the global poor, for example, Thomas Nagel pauses to describe what he sees as the absolute minimum of duties we owe to others:

> I assume there is some minimal concern we owe to fellow human beings threatened with starvation or severe malnutrition and early death from easily preventable diseases, as all these people in dire poverty are. Although there is plenty of room for disagreement about the most effective methods, some form of humane assistance from the well off to those in extremis is clearly called for apart from any demand of justice, if we are not simply ethical egoists.[40]

Minimally demanding as it is, affluent countries clearly fail to live up to Nagel's principle. Provided that there are effective measures that affluent nations could take to alleviate poverty, much more could be done without exceeding a moderate demand on the part of the affluent. First consider the scale of the problem of global poverty: among roughly 6.8 billion human beings alive today, about 1.02 billion are undernourished, 884 million lack access to safe drinking water, 2.5 billion lack adequate sanitation and 1.5 billion have no electricity.[41]

Next, consider the disparity in resources available to affluent countries: the 3.08 billion people – 45 per cent of the world's population – who live below the $2.50 per day poverty line have collectively less than 5 per cent of world income.[42] In contrast, the richest 10 per cent of individuals have 85 per cent of all global wealth; the richest 1 per cent have 40 per cent of wealth.[43] Yet official development assistance (ODA) targeted towards providing basic social services from all affluent countries amounted to just $15.5 billion in 2008.[44] That is, the total amount of ODA disbursed towards meeting basic needs by all affluent countries was only 2.2 per cent of what the US alone spent on its military in that same year. Only five countries exceed the miserly United Nations target of 0.7 per cent of gross national income (GNI) given to aid, agreed to in 1970 at the UN General Assembly.

Given these facts, it appears that affluent countries can indeed prevent something very bad from happening to other people at relatively low cost to themselves and that they are failing to do so.

It is no excuse, of course, that countries are currently facing budget crises that increase the relative cost of giving aid, since they have had these duties for quite some time. A culpable failure to discharge past duties may make duties more, rather than less, stringent. If I see a child fall into a well but decide I'd rather go to the cinema, the cost I must be willing to bear to save him or her is greater once the film has concluded.

That said, we need not endorse even relatively undemanding principles of assistance to argue that the costs of events like the global financial crisis should partly be held in common. What we have in mind is more aptly termed a duty to rescue: when, globally, accidents resulting in severe deprivation occur without negligence on the part of the parties involved, those countries with the greatest capacity to assist without suffering substantially are obliged to rescue the victims. Again, we draw inspiration from the many analogies for the financial crisis. What if, when the earthquake struck Haiti, the nearby and wealthy US had simply opted not to respond? Unlike those duties, a duty to rescue has a clear end point and is therefore not a permanent drain on our resources. Such a duty of rescue expresses a basic minimum standard for international relations – that we ought not to allow others to suffer severe deprivations when unpredictable, extraordinary events contribute to them if we can do so at relatively low cost to ourselves.

The principle of contributory fault

As we have argued, however, the global financial crisis is not entirely like an earthquake. Much of the damage was caused by identifiable agents, and this is relevant when considering how the costs to repair it should be allocated. Outrage over the bonuses received by AIG staff or at the pension demands of the former Royal Bank of Scotland head Sir Fred Goodwin is based on the belief that these individuals were responsible for precipitating the crisis and ought to pay for, or at least not benefit from, recovery measures. To put this in terms of indebted developing countries, what costs they should bear may also depend on how in the first place those countries came

to be at risk of suffering severe deprivation as a result of present financial troubles. The principle of *contributory fault* has two sides. On one hand, it can limit the conditions under which those who suffer hardships can shift the costs of alleviating their deprivations on to third parties. They cannot do so when their own negligent or reckless conduct has put them in this situation in the first place. On the other hand, it increases the extent to which these agents can shift the costs of alleviating their deprivation on to *some* third parties, namely those whose reckless or negligent conduct contributed to it. All other things being equal, reasons associated with contributing to harm through negligent or reckless conduct are commonly thought to be important because they are *stringent*. They are stringent in the sense that they *constrain* agents: prospective contributors to deprivation cannot easily justify their conduct by appealing to the costs to themselves of refraining from doing harm or by appealing to the overall good that their conduct will bring about. And they are stringent in the sense that they *demand* much of agents who have ignored constraints against contributing to deprivation, but are now in a position to mitigate or alleviate the deprivation to which they have contributed.

Drawing on the car accident analogy, let us consider how the contributory-fault principle applies to the global financial crisis. Standards of tort liability generally demand that an agent bear the costs of his or her harmful conduct when it can be shown that:

1. the agent has causally contributed to them;
2. the harmful outcome was the agent's fault; and
3. the faulty aspect of the agent's conduct (and not merely the agent's conduct as a whole) was causally relevant to the outcome.[45]

To show that some driver is liable for the injuries of another person, it must not merely be shown that the driver was negligent and that he or she caused the accident, but that the injuries resulted from his or her negligence. Theorists of the law of torts differ over how these conditions should be understood, but there are some elements that are common to nearly all accounts of them. First, the notion of fault operates with some notion of a 'standard of care'. That is, agents are at fault for some harmful outcome, and thus can be held liable for bearing its cost, when they have not lived up to an objectively defined normative standard.[46] When an agent fails to live up to this standard, he or she is deemed to be 'negligent' and is at fault for any harmful outcomes of his or her conduct. Second, the normative standard that is invoked for the purpose of determining negligence depends on some conception of what a 'reasonable person' could be expected to have done in the situation given what was foreseeable in the context in which the agent acted. If the agent acted in the way a reasonable person could have been expected to act in the circumstances, then that agent did not act negligently and is thus not at fault for the costs to others engendered by his or her conduct. Consequently, such an agent should not be made to bear these costs even if his or her conduct is causally relevant to bringing them about. If, when driving at normal speed and obeying all traffic signals, you swerve your car to avoid hitting a child dashing across the street and smash into a parked car, you are not at fault for the damage done to the parked car and are thus not liable in tort for bearing the costs of its repairs.

Of course, that no tort liability is assigned does not mean that the costs vanish, just that they cannot be pushed on to other *specific* parties on the ground of contributory fault. In the case just described, you are responsible for paying the costs of repairing your own car. Similarly, the owner of the parked car is responsible for paying for his or hers, just as he or she would have been if a tornado had picked up the two cars and thrown them together. In some cases, however, the costs may be more than the individuals involved can bear. In these cases, we argue, duties to rescue or to assist apply and some emergency costs will be held in common. Let us stipulate further that the crash occurs in the US and you are a destitute US citizen with no health insurance. If you are terribly injured in the crash, the local hospital must treat you in its emergency room. Since no one is liable for the crash, the costs of your basic treatment will be absorbed by society at large – effectively held in common – through higher insurance premiums and hospital costs. However, the costs that are shared are limited: your car will not be replaced, nor will you be provided with in-home physical therapy. Societies decide collectively how to set limits to which costs are held in common in the absence of liability. The US clearly sets a high minimum threshold and a low maximum payment for medical emergencies, whereas other Western democracies set the levels much lower and higher, respectively.

Contributory fault for countries

The principle of contributory fault can guide our allocation of the costs at the national level as well. Doing so requires spelling out a standard of care for collective agents like countries. Actually establishing what a reasonable country would do is an extremely complex task. Some principle of this kind is, nonetheless, likely to hold quite significant intuitive appeal, not least because failing to hold countries responsible for their irresponsible conduct may provide very poor incentives for the future. And it is difficult to deny that some of the damages of the current crisis have resulted from the failures of developing countries to exercise reasonable care in the management of their financial affairs. Under General Pervez Musharraf, Pakistan borrowed heavily and spent its foreign reserves on imports, only to find itself unable to repay its debts as its currency collapsed in the fall of 2008.[47] And whereas Pakistan's leader was unelected, a number of more democratic developing and emerging economies also behaved in ways that were potentially negligent. In Ukraine, paralysing political infighting has prevented economic reform for years. Latvia chose to direct foreign capital towards now much diminished real estate and mortgage lending.[48] All three – among others – have turned to the IMF for emergency loans to cover their foreign obligations.

By the same token, however, the principle of contributory fault also indicates that many poorer countries should bear lower, if any, costs of the financial crisis. The imprudence or recklessness of poorer countries did not cause most of the damage. To the extent that they were damaged by the actions they took, such as incurring debts that now, post-crisis, are only serviceable (if at all) by cutting social programmes, some of this damage is attributable to the background of the global financial system. The unstable financial environment in which poorer countries operate produces changes to their circumstances that are not only impossible for them to control, but also difficult or impossible to foresee.[49] The present financial crisis is only the most recent and vivid example of such instability.

Domestically, a borrower who makes such claims will face the challenge that these are simply the risks of market activities generally and of borrowing in particular. Economic agents should be aware that there are general risks that accompany activities like borrowing money, which include the risks of financial crises and natural disasters.

It is a common feature of contracts that those who engage in them are usually supposed to assume the risk that fulfilling the conduct will turn out to be more difficult, perhaps much more difficult, than anticipated.[50] But, critically, the law also acknowledges that there are contexts in which this supposition no longer holds. For example, if an unanticipated hurricane of unprecedented ferocity wreaks havoc on a country's economy, this event should not be viewed as part of the 'normal' background risks that agents ought to have considered when entering into contracts or in making other financial decisions. Indeed, contract law and the law of torts has made the distinction between ordinary and extraordinary events that lead to the non-performance of contracts or damages legally relevant. When extraordinary events – including so-called acts of God – lead to the non-performance of contracts, the duty to perform them is excused in many legal systems and the contract is viewed as 'impracticable'.[51] When the performance of a contract becomes impossible for reasons other than the negligence of the contracting parties, it is typically treated as void under the doctrine of frustration.[52]

Even in cases where countries have behaved irresponsibly, we should not conclude that their present and future citizens should pay the full costs. On any plausible reading of the contributory fault principle, it will not follow from the mere fact that an agent's negligence or misconduct has been a contributing factor to some harm that he or she should bear the *entire* cost of that harm. After all, other agents may also have acted negligently or irresponsibly to contribute to these deprivations. Imagine that a pedestrian crosses a busy street against a red light without paying attention to the passing cars and is hit by a driver who does not see the pedestrian because the driver is talking on his cell phone. In this scenario, one might reasonably allocate the liability for the pedestrian's injuries between the driver and the pedestrian to the extent of their fault.

This consideration may be particularly relevant when there is a clear connection between the negligence of one actor and another. For example, the negligence of one agent may have encouraged (and thus significantly raised the risk of) negligent conduct by the other. If an uncle lends a car to his teenage niece, who proceeds to drives it into a tree after drinking several cocktails, she clearly cannot (fully) escape liability for paying her uncle for the repairs to the car. However, her liability may be mitigated by the responsibility of others, if they were in turn responsible for her negligence. If a bartender served her without requesting proper identification, then this bartender (and perhaps also his employer) can also be held partially liable for the costs of the accident. And if the uncle has himself acted negligently by buying alcohol for his niece, it can reasonably be questioned whether he retains any claim whatsoever to compensation for the damages to his car that ensue from her conduct.

Contributory fault in the global financial crisis

The contributory fault principle can help us assess the allocation of costs for responding to the financial crisis. While the negligence of poorer countries may have played some role in creating these costs, the negligent conduct of other countries also seems to have contributed causally to them. In fact, regulators in the US and the UK have admitted as much. In March 2009 Verena Ross, Director of Strategy and Risk at the UK's Financial Services Authority (FSA), laid blame at the feet of the FSA and other major regulators for a 'failure to identify that the whole system was subject to market-wide, systemic risk'.[53] In the US, Christopher Cox, Chairman of the Security and Exchange Commission (SEC) – while resisting broad claims of responsibility – acknowledged that the SEC's programme to regulate Wall Street investment banks was 'fundamentally flawed from the beginning', a failure that in turn contributed to the financial crisis.[54] The SEC seems to have been particularly negligent as a regulator. Under the Bush Administration, the SEC was 'missing in action' and simply failed to regulate according to its mandate, not to mention its failure to act when tipped off regarding Bernard Madoff's Ponzi scheme.[55] The US Federal Reserve has also been a focal point of criticism. Its formerly unimpeachable ex-Chairman Alan Greenspan admitted in a Congressional hearing that his deregulatory ideology was flawed and had contributed to the current crisis.[56] Many critics, such as economist Jeffrey Sachs, go further, arguing that Greenspan's decision to keep US interests rates low after 11 September recklessly encouraged the kind of excessive borrowing that Pakistan, Ukraine and many other countries engaged in.[57]

Furthermore, the widespread official practice of guaranteeing the 'political risk' faced by lenders – the promise to the lender by its government that the latter will bail out the former and take over its claims in case the debtor government declines for whatever reason to honour an obligation – creates a double moral hazard in the international lending system. On the one hand, more capital will flow to reckless governments, which will tend to be willing to borrow more than would be prudent from the standpoint of their population; on the other hand, since creditors will have incentives to lend more, the greater their exposure will be and the greater the likelihood that their government will need to bail them out in order to prevent losses to domestic stockholders will become. This practice shifts a great deal of the risk to the population of the borrower government, which will have to repay or otherwise make other concessions to the government of the lender. In the 1970s, for example, US private banks lent to Indonesia's national oil company Pertamina, even as the US Senate Committee on Foreign Relations declared that the company's debt was uncontrollable and the IMF had put a cap on the loans that should be made available to the country. Nevertheless, banks lent above the IMF ceiling and, when the crisis broke out, the US government stepped in to bail them out and assumed Indonesia's obligations.[58]

It hardly needs mentioning that the same kind of moral hazard is at work in the numerous corporate bailouts enacted by affluent governments.[59] To give one prominent example, the New York Federal Reserve Bank chose to pay out the full face value of the debts that AIG owed to many companies that made risky bets on the housing market when the market value of those debts was clearly considerably lower.[60] The current global financial system is simply not one in which all market participants are expected to bear the risks of their choices.

Moreover, poorer debtor countries are often in so vulnerable a condition that refraining from entering into debt contracts with creditors (even particular creditors) is not a reasonable option for them. Faced with the choice of either taking out a loan that will be difficult to repay or forgoing funds needed to maintain basic services and governmental functions, the decision by a reasonable government to borrow is plausible. In domestic legal contexts of this kind, such contracts are often viewed as non-binding, either because they were entered into under severe duress or because enforcing them would be unconscionable.[61]

Even when, unlike in this case, it seems appropriate to attribute the costs of crises entirely or mainly to the negligent conduct of a country, it may be implausible to hold the vast majority of the country's present and future people solely, mainly and in some cases even partially outcome-responsible for shouldering the costs, especially with respect to severe deprivation. One main reason is that those agents who take out a loan or make financial decisions and those who are obliged to repay it are different. It is the finance ministers and other public officials of a country's government who make borrowing decisions in the name of the country, while it is the present and future citizens and other subjects taxable by the government who are asked to repay. Of course, this is not in itself necessarily problematic. Indeed, when a creditor's claims on individual agents, for example, result from decisions or policies that have been adopted by the agent's political community, and where he or she either played some role in choosing the policy *or* at least had his or her interests given adequate weight by those making the decision, there is at least a prima facie case for taking him or her to be obliged to honour them.[62] The present and/or past governments of many vulnerable countries, however, are not even *minimally* representative of the interests of those they rule, failing to give due consideration to the interests of its people in both the making of decisions and in the decisions themselves.

We have been discussing negligence so far in terms of countries. But the financial crisis has also brought to light the profound effects that corporate negligence can have on the global financial system. It is widely held that firms that transgress fundamental moral rules can be liable to bear the costs of their actions. In his famous denial that corporate social responsibilities extend beyond almost anything other than the maximisation of profit, Milton Friedman nevertheless claims that companies are free to pursue profits only 'while conforming to their basic rules of the society, both those embodied in law and those embodied in ethical custom'.[63] Financial firms in particular have apparently violated both ethical and legal norms and, in the process, have caused tremendous damage to the global poor. While individual agents may pursue civil cases to rectify these kinds of harms, for our purposes, we believe that corporate negligence on this scale also has a bearing on the assessment of national-level policy responses. A country's citizenry is responsible not only for its government officials, but also for the companies that are owned and registered in its territory, at least in countries where they can exercise some collective control over the choice of these policies.

Take the case of the Wall Street hedge fund Magnetar. Magentar exacerbated the financial crisis by betting that the housing market would fail. It sponsored synthetic CDOs – short for collateralised debt obligations, bundles of side bets on mortgages – and then bought low-cost, high pay-off insurance on those CDOs in the form of credit default swaps. Magnetar used its influence as sponsor to encourage the CDO managers to include riskier bonds, thereby making them more likely to fail. And fail they did, wiping out many unsuspecting investors, but earning vast sums for Magnetar and its employees through the credit default swaps (the hedge fund's founder earned $270 million in 2007). Despite its low profile outside of Wall Street, Magnetar became a 'driving force in the market' by entering at a time when CDO sales were expected to decline.[64]

Magnetar was not alone in recklessly inflating the housing bubble for its own gain. In early 2010 the Securities and Exchange Commission charged Goldman Sachs with deceptively selling, and betting against, investments in synthetic CDOs that it knew were designed to fail – essentially the same tactic as Magnetar's trades.[65] It is worth noting that some $13 billion of the US bailout of AIG mentioned above went to Goldman in the form of credit default swap contracts that were cashed in when those CDOs failed.

Goldman is also implicated in additional deprivations. It pioneered a new form of food speculation that engendered the recent food price crisis and pushed the number of malnourished over one billion for the first time in history.[66] In the 1990s Goldman created the Goldman Sachs Commodity Index, which includes wheat, coffee, hogs, cattle, oil and other commodities. They sold this product to investors who agreed to keep buying commodities regardless of their price. Goldman used those investments – minus management fees – to buy futures of the commodities in the index. But since they only had to pay 5 per cent upfront as a 'good faith deposit', they put the rest into Treasury bills and other safe investments, thereby earning money regardless of the performance of the index. Still, the perpetual buying of futures ensured that the price of commodities – that is, food and oil – would rise. As the financial crisis grew worse, the perpetually rising index looked like a safer bet, and more and more investors crowded into the market. The result was enormous profits for Goldman, at the expense of hundreds of millions who could no longer afford food.[67]

Of course, financial recklessness and negligence were not limited to American firms. With £1.7 trillion in assets, the Royal Bank of Scotland is the largest company in the world. The bank aggressively overbid in a 2007 takeover of the Dutch bank ABN Amro, thereby acquiring a substantial amount of sub-prime-based derivatives, and then apparently denied to its board that it had any sub-prime assets. The bank's mismanagement created enormous losses for all those involved in its vast operations and ultimately the British government was forced to spend billions of pounds to bail it out.[68]

How to allocate the costs of the global financial crisis

How should international policy-makers allocate the costs of the financial crisis? Our discussion above recommends the following approach. First, there was considerable negligence on the part of affluent countries, including official failures to adequately regulate financial firms and deliberately risky behaviour on the part of those firms. According to the principle of contributory fault, these countries are liable for the damage they have caused. They ought to pay for the costs of their own recovery, as well as the costs of the recovery of others, to the extent of their fault. Second, some developing countries were also negligent: they took out loans they were unlikely to be able to repay, or engaged in policies that made them likely to need to borrow up to an unsustainable level. In such cases, the contributory fault principle would mitigate the liability of affluent countries for this harm and assign it to an appropriate extent to any negligent developing countries. Third, some countries have contributed negligently to their own downfall but are now so badly off that some of the costs of their recovery should be held in common. Even though they were negligent, the severe deprivation of their citizenry may be such that we ought to rescue them when we can do so at relatively low cost.

Returning to the contributory fault principle, one might object that there is not enough evidence to bring criminal, or even civil, charges against Alan Greenspan, Christopher Cox and other regulators (however, there is enough evidence for the SEC to bring civil charges against Goldman Sachs). But, as we have argued elsewhere, criminal or even civil liability standards are not appropriate for the ethical reflection that should guide international policy-makers in this case.[69] In a criminal case we generally prefer that the guilty go free rather than that the innocent be falsely convicted, and we construct the rules accordingly. But ethical reflection on policy orientation does not call for such a high standard. Rather, for the task at hand, the burden of proof, the standard of proof and the constraints on admissible evidence ought to be designed in order to express a presumption in favour of the severely deprived. In other words, when the lives and livelihoods of the world's poorest people are at stake, our standards for ethical reflection should err in their favour. However these standards are precisely specified, they must hold the world's financial giants, especially the US, the UK and their financial firms, morally liable for harming the developing world.

Even a cursory review of the evidence indicates that affluent countries have not yet made a significant effort to pick up the tab for the financial crisis. As we mentioned in the introduction, requests to share the costs of fiscal stimulus have been largely rebuffed. The President of the General Assembly's call for a $3 trillion stimulus was echoed by the IMF, which urged governments to implement a stimulus of 2 per cent of world GDP.[70] So far, however, the combined global fiscal stimulus amounts to $1.98 trillion, only 1.4 per cent of global GDP.[71] These figures are unlikely to increase much further, as the talk at the G-20 has now shifted to cutting deficits.

Nor has there been a great outpouring of direct aid, despite the promising words at the April 2009 G-20 summit. A UK House of Commons report noted that affluent countries generally intended to uphold their levels of aid as a percentage of GDP, but that since incomes are declining, this actually implies a decrease in aid.[72] Indeed, total ODA fell by about $3 billion from 2008 to 2009.[73] And these aid levels are still well below what affluent countries promised to give at the 2005 G-8 summit. Signs for the future are mixed. Several countries that were themselves badly affected by the crisis have slashed their aid budgets; Ireland, Italy, Greece and Portugal have all cut aid budgets by between 10 and 30 per cent.[74]

To bridge the financing gap, developing countries have had to turn to the international financial institutions, particularly the IMF. IMF lending is expected to increase by up to 40 per cent by 2012.[75] However, these loans have been much criticised over the years for their conditionality. Ukraine, for instance, complained that it would have had to reduce social spending in order to be eligible for additional IMF funding. While a detailed analysis of the human impacts of IMF conditionality is beyond the scope of this chapter, our analysis above gives us some reason to question this method – conditional IMF loans – as a means of responding to the crisis.

Moreover, affluent countries, especially the US, have done little to discharge their responsibility for their corporate actors. Having failed to do so by extending aid to repair the damage from corporate negligence, affluent countries could at least act to ensure that the ability of financial firms to harm developing countries is limited in the future. The US Financial Reform Act does not fundamentally alter the ability of financial giants to inflate another bubble. Nor does it curtail the ability of industry lobbyists to influence the application of rules in their favour.[76] And it is entirely silent on the food speculation that starved millions during the lead-up the crisis.

What would a more appropriate policy response look like? Aside from more equitable stimulus spending and effective financial regulatory reform, governments should give careful consideration to the ramifications of using the IMF as the main vehicle for developing-country assistance. Only three countries, Colombia, Mexico and Poland, are eligible for conditionality-free loans. Others could in principle access conditionality-free financing through special drawing rights (SDRs). The G-20 touted the allocation of $250 billion in SDRs at its April 2009 meeting, but in reality only $82 billion will go to developing countries and only $16 billion to low-income countries.[77] Currently SDRs must be allocated along quota lines, which give the lion's share to affluent countries; governments could consider relaxing this requirement. Similarly, the IMF's move to reduce the interest rate on concessional loans to zero is laudable, but the overall effect will be limited. Countries will only save about $1 million per year over a two-and-a-half-year period.[78] There is clearly room for more aggressive action by those with the greatest capacity.

Moreover, we should question the wisdom of pushing poorer countries even further into debt as a means of rescuing them from a debt-induced crisis. Affluent governments should offer no-strings-attached development aid in the form of grants rather than loans where possible, insofar as it seems likely that doing so would benefit the recipient populations.[79]

Our car crash brings out the absurdity of the current situation. If a driver smashes his car into a victim's home, the driver cannot make good on his actions by offering to let the victim borrow the cost of repairs from him. It makes no difference if the repairs to the car itself will be costly; the driver still bears the burden of repairing the damage to the victim's home. Even if the victim encouraged the damage by building his home close to the busy road, the two then share responsibility to the extent of their individual fault. And if, as in the present case, the driver is fantastically wealthy and the victim is a pauper, and there is no one else to help, then the driver should aid the victim even if neither were at fault.

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