

RESTORATIVE JUSTICE FOR BANKS THROUGH NEGATIVE LICENSING

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The most general lesson of the crime prevention literature is taken to be that repeat victimization and repeat offending are concentrated in time and space; early intervention to prevent wider inflammation of such hot spots is more effective than reactive general deterrence (as in economic models of crime). That prescription is applied to how the 2008 financial crisis might have been prevented and how the crimes of Enron and Arthur Andersen might have been tackled to ameliorate the 2001 crisis. Negative licensing based on walking the beat and kicking the tyres at financial hot spots, with reduced reliance on economic models of risk, is one remedy advocated. Then, the threat of negative licensing might be used to motivate restorative justice that transforms the ethical culture, particularly the bonus culture, of banks.

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What Works?

Here is one crude way of summarizing the ‘What Works?’ literature in criminology (e.g. Sherman *et al.* 1997). Strengthening the criminal law—expanding its scope, increasing police powers, easing burdens of proof, raising penalties—is rarely counted among the most effective interventions in reducing crime. Yet, when it comes to a financial crisis, criminologists join the assumption that strengthening regulation, conceived in the expanded-criminal-law-powers paradigm, is the priority. Better laws on hedge funds and derivatives are needed. Yet, believing they will fix the problem and prevent future disasters is like arguing that tighter regulation of gas chambers would have fixed the Third Reich.

The intuitions of Main Street are right that the masters of the universe on Wall Street who caused this crisis should not be left in charge. Yet, more than a new oligarchy is required; institutional transformation of finance capitalism is needed. That can only be accomplished with a dose of socialism until we institutionalize architecture of a reinvigorated financial capitalism that manages risks instead of gaming them. Crisis will become more endemic if we allow bankers to pass the parcel or plead ‘we are too big to fail’ when the music stops with them holding bad assets.¹ A financial architecture that is more risk managing rather than risk shifting is not impossibly hard to build. Most of Asia’s banks, most of the banks in Australia and in Canada have it now. America’s banks used to have it. It’s the politics that is hard. The Obama Administration must topple the

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¹In July 2007, the then chief executive of Citigroup, Charles ‘Chuck’ Prince, said ‘When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you’ve got to get up and dance’ (O’Brien 2009: 10).

old oligarchy, some of whom it embraced within its ranks, and rebuild the institutions of Wall Street as risk managing and not just risk shifting institutions.

Reinvented privatised banks are then needed because a new socialist oligarchy is one of the few things that could be worse than the current Wall Street oligarchy. The most important element of a new regulatory architecture is not the regulation of the financial products that brought on the crisis. Risk shifting capitalists will hire financial engineers to build new risk shifting products (not conceived of in the new laws) that game their way to the next boom. The most crucial need is enforcement that removes irresponsible risk shifters as soon as hot spots of failure to manage risk appear. That requires more regulatory bureaucrats kicking the tyres of financial institutions. Second, it requires negative licensing laws that institutionalize the clean-out of risk shifting oligarchs. President Obama needs to do that as an act of political fiat right now in the banks he is bailing out. Third, I argue for restorative justice conferences in financial institutions that the new cadre of regulatory bureaucrats implement as soon as they detect failures to manage risk. This is fleshed out by first considering the fundamentals of what does work in crime control and why negative licensing and restorative justice are responsive to those insights.

Target Hot Spots

What are the kinds of things that do deliver in the ‘What Works’ literature? They include identifying hot spots, high-risk spaces, times and groups of people, and targeting smartly attuned preventive and rehabilitative measures at the hot spots (Sherman 1995). Targeting improved detection at hot spots helps when that leads to evidence-based interventions; we know from the perceptual deterrence literature (e.g. Paternoster and Iovanni 1986) that improved detection makes more difference than the increased punishment that might or might not be delivered by stronger laws. Further, we know that the best predictor of who will be a victim of burglary is living in a dwelling that has been burgled in the past year (Pease 1998). We know that young men who are released from prison have a remarkably high probability of going back to prison.

So, it might be wise to apply these fairly banal general lessons from criminology to how to prevent the next global financial crisis. We would look to early prevention by finding the banks in the world system that had the highest density of bad loans. That was easy to do, as housing loan defaults were being counted for years before this crisis. In 2007 and 2008, those banks would not have been located in the half of the world that is Asia. Improved national and international oversight after the 1997 Asian economic crisis actually left those banks more conservative, prudent and accountable than they had been before 1997. The dominos of the Indonesian financial system that fell in 1997, for example, have stood strong in 2008 and 2009. Nor did China and India have major toxic asset problems. The world has a global economic crisis—but only a regional, North Atlantic banking regulation crisis. It is concentrated in the same financial hot spots where a cognate regulatory problem is concentrated, the corporate tax shelter problem. Empirically, the world’s two biggest tax havens are both islands—Manhattan and Britain (Braithwaite 2005). New York and London created capitalism’s badlands by promoting the idea that risks were things smart people shifted rather than controlled and accepted responsibility for. The risk shifting society spread across hinterlands of these two hot spots.

Had we tackled early prevention from 2004 at the banks in the world system that showed early warnings of abnormal loan defaults, most of those hot spots would have been banks in the United States. We do not have an evidence base for what would have been the most effective way to do preventive, rehabilitative and deterrent work at those hot spots. To get to that point, more evidence-based criminologists must work on these problems. They are currently solved by economists on the basis of economic theory and lawyers who have a hammer (reform the law) and see a lot of nails. These perspectives are important, but not as important as reform of regulatory enforcement.

Just two ideas are considered here—negative licensing and restorative justice. Restorative justice has an evidence base to support its effectiveness more broadly (Braithwaite 2002; Latimer *et al.* 2001; Bonta *et al.* 2006; Sherman and Strang 2007); negative licensing does not have any systematic evidence to support it, though there are many case studies of its successful application (e.g. Braithwaite *et al.* 2007).

Bottom-Up and Top-Down Negative Licensing of Executives

The global recession started at a micro level. Mrs Smith and Mr Jones were given bigger loans for bigger homes than they could afford. Often, there was fraud; US banks encouraged them to inflate their income, for example. The bank blames Mrs Smith for its predatory lending. Banks believed financial engineering would shift the risks to others. Mrs Smith's default risk was bundled with thousands of other loans. Then, that bundle of loans was divided into securities for sale. The bank shifted the risk to other banks that bought shares of the loans. They did so because ratings agencies got rich from the lure (Shover and Hochstetler 2006) of fees that gave them incentives to certify the securitized risks AAA.

Everyone in the system believed they were using clever financial engineering to shift and spread their risks. With no one owning and confronting the risk of bad loans, bad loans in the system grew to the point at which a crisis was waiting to happen with any shock to market confidence. The primary purpose of derivatives in contemporary capitalism is to allow financial institutions to get around regulatory responsibilities (Partnoy 2003; Braithwaite 2008: Chapter 2). While law reform is needed there, so is a reconfigured enforcement assault on the culture of risk shifting.

If we write a home loan to Mrs Smith, we have a responsibility to ensure it is a loan she can afford when times get tough. That is a banker's responsibility to Mrs Smith and to the solvency of our society. We can remedy insolvency with regulatory institutions that require those who sign unconscionable contracts to be ethically responsible for them. Aggressive enforcement of negative licensing laws that exist in Australia and New Zealand for regulating finance brokers and insolvency practitioners is one remedy. The idea is not to require a bank officer to have a licence before they can issue a loan or manage a bank. That's a positive licence. A negative licence means the regulator can issue an order that the individual banker be banned from working in the finance industry.

Countless thousands have lost their jobs in US banks. It would have been more just if a few thousand of these innocent employees were able to take the jobs of morally culpable bank executives who were negatively licensed out of the sector. Then, future use of negative licensing would be a credible threat to get bankers to take notice of their responsibilities. The way this strategy could have targeted early prevention at the first

hot spots to appear might have been as follows. US prudential regulators would have been regularly monitoring bank branches that reported actuarially high default rates. Years ago, they would have arrived at those branches to kick the tyres. They would have found false representations of the incomes of borrowers on loan documents and other clear evidence of predatory lending. Bank managers with their signatures on those loan documents would then have been negatively licensed out of the finance industry from 2004. The idea is this would have nipped in the bud the contagion of risk shifting that spread across the world from what was initially a tractable set of hot spots in the United States. Hot spots only spread to become systemic risks if there is a failure to deploy simple regulatory technologies when they first appear.

A limitation of this strategy is that it can target fungible middle managers, while the masterminds of risk shifting capitalism march on. The kind of restorative justice advocated in the next section is one response to this designed to transform institutions. A second is that once bottom-up negative licensing has failed, the crisis that follows creates an opportunity for top-down negative licensing of financial oligarchs and whole banks. When oligarchies bankrupt lesser societies than the United States, as they regularly do, the IMF marches in and gives the leadership no choice but to cut off the flow of blood to some of the bigger bloodsuckers. In many cases, the old political leadership cannot survive this. Indonesia was an example when President Suharto fell in 1998 after being forced by the IMF to end the haemorrhaging to his oligarchs, who then abandoned him and caused his fall. The IMF does not march into Washington because the IMF *is* Washington. In recent history, the IMF has touted the Washington Consensus, a set of rules that suited the masters of the universe when those in servitude abided by them. But the Washington Consensus was also about the fact that the masters of the universe were themselves above those rules. It was a system of hegemonic ‘do as we say, not as we do’. Few societies have been less compliant with the Washington Consensus than the United States.

What was right about the Washington Consensus was that fiscal and monetary disciplines are good things. It is unwise and unsustainable for individuals, for banks and for nations to live (persistently) beyond their means. America’s tragedy is that, for a long time, it has needed some of the discipline that the IMF inflicted on others. Discipline is not in the interests of those atop a gravy train; they want those bonuses to keep coming in until they make it to retirement, leaving clean-up to the next generation of bankers. Former IMF chief economist, Simon Johnson (2009), argues that a recurrent feature of bankrupt nations is that, during booms, as bigger risks pay off, business elites close to the regime take ever wilder risks, confident that the political elite they prop up will bail them out if they falter. The challenge for leaders of bankrupt states is to find the courage to cut off support to the financial oligarchs and the organizations they have created. This is about stopping the national haemorrhaging from them. And it is about creating a space for new prudent banks that will inspire trust.

Because the IMF is institutionally incapable of saving America, it can only be saved by a leader brave enough to take on the oligarchs. They do not come along often. Hopefully, President Obama may be such a leader. Part of the legacy of one leader with that kind of greatness, Franklin D. Roosevelt, was the IMF. Theoretically, the IMF was supposed to enforce fiscal and monetary discipline upon all nations, including the United States. But, with the United States pulling the strings at the IMF, that proved a dream. America’s paradox now is that it will do best by its people to empower China and other more

solvent nations to discipline America's masters of the universe. China and the rest of the G-20 must learn the lesson that they failed their people by not demanding action at US hot spots. It was a failure of their financial intelligence not to recognize the global risk of the increased delinquency rates on US residential mortgage loans that began in September 2006, accelerated sharply from mid-2007 (IMF 2009: 23) and was preceded by public FBI warnings of an epidemic of mortgage fraud in 2004 (Black 2009). Bad medicine for the masters of America is not bad for the people of America, even if it tastes unpleasant when prescribed by China.

President Obama needs to be a strong enough leader to support a new national and international financial architecture that will institutionalize distrust in Wall Street's oligarchs. Johnson (2009) argues that Democrats and Republicans blame different drivers of the crisis. Democrats blame regulators asleep at the wheel; Republicans blame the flow of savings out of China, the unwritten Chinese–American economic alliance and excessive promotion of homeownership for the poor. Johnson argues the failings attributed by each side of politics to the other share in common being policies that pleased the investment banking elite. New York and London have the most sophisticated business oligarchy in the world. It does not rule mainly by stuffing dollars into the pockets of politicians, though it does do that. It rules mainly by bluff and hegemony, by persuading political elites that it knows what it is doing. Politicians did not understand the bankers' risk management models, but they believed their incredible sophistication was helping to extend the boom and cushion the busts of previous business cycles. The financial oligarchs did not understand them either; the models were just a good story that they bought from economists who were happy to be well rewarded for not talking too loudly about their shaky assumptions and the gaps in what they were able to quantify.

These oligarchs do need to be incapacitated because they are still doing damage, still paying themselves obscenely to do it, still paying modellers to con us into believing that they are coming up with the answers, when the answers of interest to them are not ones that will best heal the world economy. Their answers are crafted to save themselves. Some of the American oligarchs are still behaving like addicted gamblers—afraid to expose or face the truth that they are insolvent, demanding taxpayers' money to place new bets that could pay big winnings, but are more likely to lose. Putting them in jail to incapacitate them is not important; putting them out of their offices, quickly, is fundamentally important. This has not happened on the scale or with the speed needed. That is standard in a crisis induced by financial oligarchs; the politics of incapacitation and cutting the losses is always painful and therefore always insufficiently ruthless with con-artists whom the politicians would still love to believe.

Wise financial crisis management in the first instance shuts down the oligarchs who caused the crisis and stops their financial rot. It nationalizes their banks and breaks them up. Or they can be re-privatized whole, but on condition of selling off large chunks of themselves within contracted periods. It is about building new institutions of capitalism in which trust can be renewed. New ethical banks that are not too big to fail are a better idea than propping up institutions that were the architects of the looting. As Johnson (2009) puts it, 'Anything that is too big to fail is too big to exist'. More moderately, prudent politics minimize their hostage to the fortunes of organizations that are too big to fail. They accomplish that by rigorous antitrust enforcement.

Then, the ratings agencies must either transform themselves or suffer corporate capital punishment. The world cannot afford a Standard & Poors with an executive who

could say ‘let’s hope we are all wealthy and retired by the time this house of cards falters’, or another who said ‘We rate every deal. It could be structured by cows and we would rate it’, and another ‘Profits were running the show’ (O’Brien 2009: 75). The ratings agencies made AAA gold out of defaulting loan dross. Because the ratings agencies will probably be incapable of ethical transformation, it will likely be best to kill them off. If Obama is not the sheriff who can clean up his badlands, then the European Union might do well to create a non-profit ratings agency that does shoe leather due diligence at hot spots instead of shonky modelling. It would compete with Standards & Poors and Moody’s for international business with the pitch that its ratings are more trustworthy. The United States, in turn, needs legislative authority to negatively licence its ratings agencies. By threatening to march in, throw out the management, and run them as government ratings agencies if they allow a crisis of poor ratings integrity anything like that of the feckless financial establishment of 2008, the Obama administration might just be able to induce the ethical transformation needed in the ratings business. In the current crisis, the systemic risk of conflict of interest in the ratings agencies proved so profound that an enforcement pyramid (Braithwaite 2008) with anything less than corporate capital punishment at its peak would seem reckless.

The next institutional transformation needed is of the bonus culture of ‘heads we win, tails shareholders lose’. Capitalism worked better when investment banks like Salomon Brothers, Morgan Stanley and Goldman Sachs had partners who would lose everything if the partnership failed (Bhidé 2009). The rules of the bailout machine can be changed to mimic this past virtue. When small businesses start sinking, lenders seek to repair them at sea by making owners sign personal guarantees that their last cent will go into filling the hole. Bailouts would not be as big a moral hazard if the captains of Wall Street’s ships were actually bailing as their ships took water. But, when captains instead are allowed to load themselves up with gold and head for a life raft, it smells of cronyism. Preventively, Prime Minister Rudd of Australia has headed in the right direction by instructing the Australian Prudential Regulation Authority to propose a mechanism to require banks to keep more capital in reserve if they pay bonuses that, in the judgment of the Authority, rewards risky short-termism in investment (Franklin 2009). This is a good example of how prudential regulation must shed the malaise of the more measurable driving out the more important. Quantitative models are useful for guiding reserve requirements, but must be supplemented by qualitative diagnoses of wise heads thinking about what is making hot spots hot.

Finally, the IMF must be radically reformed so that it can discipline even Wall Street in the interests of the people of America. Yes, then, finally, some new regulations are needed to cover the existing gaps in the regulatory coverage of derivatives and hedge funds. That is important, but it must be viewed within a perspective of assurance that a new generation of masters of the universe will struggle for power through a new era of financial engineering to game the new rules. Much more important is a new modality of regulatory enforcement that is deliberative, restorative, responsive, but also potentially incapacitative through negative licensing. US Treasury Secretary Geitner’s plan is to require hedge funds to register with the Securities and Exchange Commission and disclose certain financial information (Clark 2009) (limited positive licensing that the London G-20 also agreed for both hedge funds and credit ratings agencies (G-20 2009)). This is no substitute for the power to negatively licence hedge funds, like credit ratings firms, and the individuals who control them, so the state can take them over and put

ethical managers in charge. If we can threaten that power to potent effect (while rarely having to use it) with pygmies of capitalism like callous nursing home proprietors (Braithwaite *et al.* 2007), we should be able to do it with the giants of Wall Street.

Restorative Justice

This section of the paper takes us back to the last financial crisis (of 2001) to argue that restorative justice could have prevented the collapse of Enron! After 2000, when Enron and Worldcom collapsed in the United States, and this, in turn, led to the collapse of their auditor, Arthur Andersen, there were bankruptcies of some major Andersen-audited firms in Australia, the most important of which was our insurance giant, HIH. What could regulatory agencies have done to prevent the misconduct that led to the collapse of Enron, Worldcom and HIH? I made one suggestion at a meeting of the Australian Tax Office Aggressive Tax Planning Committee. I pointed out that two members of the Committee had separately said during my interviews that they had the following experience in the late 1990s. A Big Five partner got one of their wealthy clients into deep trouble for tax cheating. A more senior partner then visited the tax officer and said ‘This is a rogue partner and we are going to get rid of him. We would hate you in the Tax Office to think that other partners condone what he did’. My suggestion was that such an encounter creates a golden opportunity for the regulator to tackle the ethical climate in the major accounting firms and investment banks. So, I argued that the senior tax officer should reply:

That’s good that your other partners do not condone this and I’m pleased to hear it because we at the Tax Office were disturbed by the non-compliance that occurred here and are always concerned with something of this gravity that it might reflect a culture of non-compliance in your firm. Could we have a meeting to discuss this with all your partners?

When they agree to this, and regulatory experience with restorative justice elsewhere suggests that they would (Parker 2004), it would be requested that the meeting be facilitated by a restorative justice practitioner. This facilitator would insist that the ‘rogue’ partner who was about to be scape-goated also attend. She would be the first person asked to speak by the facilitator. She would tell, in her own words, how the incident that got her into hot water had occurred. It might turn out, if this were Arthur Andersen, that the ‘rogue’ partner was not a rogue partner at all, but a fall-guy, who was actually following the culture of the firm. Then, in the conclusion to the conversation about the harm that has been done, when everyone in the restorative justice circle is asked what they think should be done to ensure nothing like this happens again, if someone else has not already suggested it, the regulator could request an audit of the firm’s systems for compliance with ethical standards. That independent evaluation of compliance systems would be conducted by a consultant whose independence enjoyed the confidence of both the firm and the Tax Office. Its recommendations would be reported back to a reconvened meeting of the restorative justice circle, which would discuss whether they went far enough. It would normally be made public for the purpose of catalysing wider crime prevention. A year later, the circle might be convened again to receive a report from the accounting firm and the consultant on how thoroughly the reforms to the compliance culture had been implemented. Active engagement of an errant Arthur Andersen with such a restorative

justice process is enabled by the Tax Office being able to threaten the licence of an Arthur Andersen to offer tax advice. Without the power to escalate to corporate capital punishment by negative licensing, firms might not cooperate with restorative justice.

The Tax Office was one of a number of Australian regulatory agencies receiving reports of dubious ethics by Arthur Andersen in the late 1990s. So, there were multiple agencies on multiple issues with an opportunity to catalyse a major ethics self-examination of Arthur Andersen before their conduct brought down companies like HIH, Enron and itself. It would be surprising if that were not also the case with US regulators. The beautiful thing about this regulatory strategy with global firms is that, even if it has no appeal to US regulators, there is a possibility that its application by the Australian Tax Office to Arthur Andersen's ethically questionable profit shifting into tax havens on behalf of Australian firms might have lifted the lid on similar work it was doing for firms like Enron in the United States. The more regulatory agencies around the world that were using restorative justice in this fashion on the Arthur Andersens and Enrons, the more unethical firms like these would have their ethics globally exposed. The ethical exposure of Enron in turn might have exposed other masters of the universe. As the Regents of the University of California alleged in their civil complaint against major investment banks, 'This fraudulent scheme could not have been and was not perpetrated only by Enron and its insiders. It was designed and/or perpetrated only via the active and knowing involvement of Enron's banks, including JP Morgan, Citigroup, Credit Suisse First Boston, Merrill Lynch, Deutsche Bank, Barclays, Lehman Brothers and Bank of America' (O'Brien 2009: 44).

A relevant strength of this restorative justice strategy is that it can move regulators in on hot spots long before they light conflagrations like the string of 2001 collapses. The philosophy is that it is a mistake to wait until there is enough evidence to launch a prosecution. This was a not dissimilar regulatory failure to the FBI doing nothing about persons of concern learning how to fly aircraft (without showing interest in how to land them) because they could not see a collar. In the case of the predatory lending problem that first became evident to the FBI in 2004 (Black 2009), restorative justice conferences in some banks whose managers were being investigated with a view to negatively licensing them out of the finance sector in 2004 might have revealed that the pattern of predatory lending was not yet very serious. The restorative justice conference at the bank might not have sanctioned anyone, but might have served as a warning shot that prevented the problem deepening at that bank. This is an application of what I take to be the fundamental lesson from the 'What Works?' literature that we make the biggest impact on crime by proactive crime prevention at hot spots, not by general deterrence after the damage is done.

Movement back from risk shifting to risk management will prove in the long-term interests of banks. Wise old bankers knew that all along. That is why we can find so many quotes from them about their past fears about the 'house of cards' collapsing. These wise heads within Wall Street might have jumped at the opportunity to save their bank through a restorative justice confrontation about the need to abandon the philosophy that they could keep shifting risks rather than managing them. Structurally, the risk shifting society is untenable in the long run, as well as unethical. This is why its abuses could have been prevented by the organizational ethical deliberation that is such a strength of restorative justice (Braithwaite 2002). If the problem that was driving predatory lending in a particular bank was a bonus culture based quantitatively on

short-term profits from trades or loans sold (without regard to loans defaulted), then what might be called for in the restorative justice circle might be old-fashioned bonuses based on contributions to the long-run profitability of the firm.

Homeowners in the United States suffered about seven times the losses of banks as a result of this crisis (Krugman 2008: 169). The rational way to minimize the losses that both homeowners and banks are suffering as a result of foreclosure is to cut a deal with the homeowner to reduce payments. Paul Krugman (2008: 167) argues that this did not happen precisely because the mortgages had been sliced and diced into collateralized debt obligations. Whoever the loan originators were, restorative justice conferences were needed to require them under threat of wider negative licensing of the institution to repair the harm by covering the loss from reduced repayment schedules that kept people in their homes. Then, law reform is needed to help those banks recover some of that loss from the other banks that had purchased a small slice of the mortgage. But, the ideal would be that these part-owners of the mortgages would voluntarily agree to this as part of restorative justice agreements because they would be the ultimate beneficiaries of reducing the losses associated with foreclosure. Leaving fine homes empty or bulldozed while homelessness spreads is the economically wasteful and immoral outcome that can be averted by reaching a conversational solution to this regulatory tangle.

Structural Explanation of Ethics and Structural Transformation of Ethics

We can see that better laws are only a part of the solution by imagining a world in which financial regulation was so total and perfect that it was impossible for a banker to behave unethically. The problem in such a world is that it would also be impossible to behave ethically. And ethical judgment is something that withers when it is not matured through use. That is part of the case for responsive regulatory pyramids that *enculturate* trust, while they *institutionalize* distrust (Braithwaite 1998). At the bottom of the pyramid, the norm is one of trusting managers to hone their ethics through use, and through ethical deliberation with peers. But criminal exploitation of trust triggers inexorable escalation up a pyramid of checks and balances. Responsive regulation of abuse of trust is not enough, however, because ethical behaviour is also shaped by structures of inequality. The ethical society must be economically just, or at least must constantly struggle against extremes of injustice, as well as being responsive.

Like many criminologists, I have long argued that the evidence supports the contention that societies with both great extremes of poverty and great extremes of wealth have the deepest crime problems (e.g. Braithwaite 1991). They experience crime in the streets because the poor are exploited and crime in the suites because elites exploit. Both the very poor and very rich experience anomie as normlessness of different kinds. The poor experience anomie (Durkheim 1897) as disengagement from the normative order; oligarchs enjoy the anomie of being above the rules (rules they believe should apply to others). Oligarchs game the normative order rather than disengage from it (Braithwaite 2009); they benefit from the respect others show to their property rights, feigning support for property rights that they corrode in their own business practice. Their crime is about Lord Acton's dictum that 'power corrupts, absolute power corrupts absolutely'. America's badlands (far from all of America) have both extremes and, as a result, have abundant crimes of poverty (in the South Bronx) and crimes of oligarchy (on Wall Street). Other societies have only one side of this problem in large measure. President

Suharto's crony capitalism between 1966 and 1998, for example, was a world of extraordinary wealth for a small oligarchy, but was one of the top ten nations in the world in the share of national income that went to the poorest 10 per cent. It was, according to Transparency International, the most corrupt nation on Earth, but had quite a low homicide rate and safe streets.²

Both the gaming of the rich and the disengagement of the poor from the normative order create mutually reinforcing crises of ethics for a society. The normlessness of an underclass is vindicated for them when the pillage of oligarchs becomes visible. Oligarchs learn that they can pillage with impunity because they think political leaders cannot do without their support. Political leaders worry deeply about masters of the universe shifting their mastery behind the political machines of their opponents. This is what allows oligarchs to game the rules with impunity. Experience teaches them that they can play ever more economically and ethically risky games, safe in the assurance that the political leaders they have kept in power will cover for them or bail them out, or both. The oligarchy's burgeoning risk-taking drives ever larger returns that buy ever greater mastery of politics.

Ultimately, however, the West can now see what the East saw in 1997—that risk taking can go so far as to cause collapse of a whole economy. That is what happened in 2008 in the relationship between the Wall Street elite and their servants in Washington. It was not greased by anything like the level of corruption of Suharto's Indonesia that caused its massive economic collapse of 1997. The Washington Consensus was much more hegemonic (Gramsci 1971). Middle America was on side with the Washington Consensus, as their share portfolios fattened on phony assets engineered by the finance oligarchs. Even after Enron caused a collapse, middle America continued to vote for its clients in the Bush administration, at least until the second, bigger collapse of 2008.

While the rich, the middle class and especially the homeless poor are all losers in the 2009 recession, a new progressive politics links the poor and the middle class, who both resent oligarchs who play 'Heads I win, tails you taxpayers, shareholders and homeowners lose'. They don't think that they should be the ones worrying about insolvency when those who played that game scoot to early retirement, recovering their bonuses in a Caribbean tax haven. It is encouraging that the G-20 London summit of 2009 decided to go after tax havens as part of its reform agenda. The United States can create a great pool of resources to tackle poverty, pay for health care, by beginning to tax the very rich again (Braithwaite 2005). Transforming the bonus culture born on Wall Street through tools such as those above can not only directly increase income equality, indirectly, it can build businesses that create more jobs for the poor by replacing short-termism with long-termism.

It comes with the territory of pushing forward the frontiers of capitalism that America has created capitalism's badlands of normlessness. Other nations have been able to create more civilized social democratic forms of capitalism, partly because they have been able to sit back and learn from mistakes that America made on that frontier (with this crisis, the frontier of financial engineering). But the history of American capitalism has followed its largest crises with periods of profound progressivism—the Progressive Era at the start of the last century and the New Deal. This included the invention of progressive forms of taxation and forms of regulation in the United States that made these institutions more redistributive than their counterparts in Australia, for example (Braithwaite 2005; 2008: Chapter 1). Obama's time can be yet another era of

²This is the subject of Chapter 1 of a new book on peace building in Indonesia by John Braithwaite, to be published in 2010.

transformative American leadership for civilizing all the world's capitalisms if he opts for a politics of responsive incapacitation and restorative justice rather than a politics of deterrence and retribution of the kind that Bush feigned after Enron.

A Tale of Two Mertons

Robert Merton (1949) laid the theoretical foundations for the thesis that inequality worsens crimes of poverty motivated by need (for dignity, for goods for use) and crimes of oligarchy motivated by greed (lured by goods for exchange) (Braithwaite 1991). Crime in the suites is lured by great wealth and power; crime in the streets is born of its absence. Many children in poor families commit crime because they are abused and exploited; many rich adults commit crime because they exploit and imbue a culture of exploitation. Structurally, less exploitative societies are likely to have less of both kinds of crime. The bonus culture has already created a wave of crime in the suites; in future decades, it may create a new wave of crime in the streets as children grow up in families that experience long-term unemployment and homelessness.

Merton never won a Nobel Prize for the insights of 'Social Theory and Social Structure'. His son, also Robert Merton, did, for his intellectual paternity of the new financial engineering. The hedge fund the younger Merton inspired and steered as a board member, Long Term Capital Management, made stupendous returns in the 1990s partnering with Bear Sterns, Merrill Lynch and a Cayman Islands company, but then collapsed in 1998. One Merton is part of the problem of contemporary capitalism; the other is part of the solution.

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