Constitutive Conflicts: Conflicts of Interest, Institutional Power, and the Crisis of Finance Capitalism

John W. Cioffi
Department of Political Science
University of California, Riverside

Law & Political Economy Project,
Transforming Private Control Over Political Production
March 18, 2021

Abstract

Conflicts of interest (COI) constitute the most persistent and insidious threats to good political and economic governance, the rule of law, and representative democracy. COI are typically conceived as exceptional pathologies or incidental defects in institutional design of the legal and political economic order. They are also commonly compartmentalized within either the public sphere (e.g., governmental corruption, agency capture, or structural features of constitutional design) or the private sphere (e.g., principal-agent problems afflicting market or firm governance, or professional standards of conduct). Finally, within the paradigm of neoclassical economics, they are conceived as contracting failures, rather than as more complex and dynamic institutional structures and relations. These common framings miss three critically important aspects of COIs. First, COIs often are *enshrined in and enabled by law*, and their near-ubiquity across time, space, and social context makes them *unexceptional* as an empirical matter. Second, *COIs are institutional phenomena* defined first and foremost by the institutionalized *structure of power relations* that endow a group or class of actors with organizational authority and control. Third, because of the recursively self-reinforcing dynamic of these power relations, institutionalized COIs are often potent *constitutive sources of political and economic power* that have profound effects on politics and economic organization. Legal and institutional theories must accommodate and elucidate these dimensions of COIs. Comparative legal and institutional theory are both necessary and ideally suited to inform each other in the comparative analysis of COIs. Empirically, the particular configuration and articulation of COIs should limn the architecture of power in different political economic regimes. An examination of the genesis of and policy responses to the global financial crisis reveal a proliferation of conflicts of interest that generated an increasingly extractive and destructive financial architecture as well as the increasingly asymmetric power wielded by managerial and financial elites to reform the legal system for their own benefit.

I. Introduction

Political and economic history is in no small degree the history of conflicts of interest. The history of law, constitutionalism, and regulation is likewise the record of the recurrent (or endless) battles between those who seek to construct and exploit conflicts of interest and those devoted to eliminating or at least containing, policing, and constraining their abuse. They are, in

important and often perverse ways, often defining features of the architecture of political, economic, and social order, and constitutive of the configurations of power that underlie them.

It should hardly be hardly controversial to note that conflicts of interest constitute some of the most persistent and insidious threats to good political and economic governance, the rule of law, and representative democracy (though there are those who would dispute the proposition). Unchecked, they undermine the functionality and the legitimacy of institutions of government, law, and governance. In the absence of countervailing forces of constraint, they can propagate corrosive cynicism and unbridled self-interest capable of dissolving alternative norms of justice, equity, equality, and loyalty. Where the prevailing perception of the status quo by members of the polity is that "the entire game is rigged,' there is likely no sense of common interest or shared fate, no reason for self-restraint or sacrifice. This is bad enough, particularly in our blighted age of legitimacy crises and a political economic terrain littered with figuratively and literally bankrupt institutions. But there is an even more troubling dimension of conflicts of interest as they pertain to power and institutions.

Notwithstanding their near universal recognition as corrosive and destructive, conflicts of interest are also *constitutive* of the political economic order. This may at first appear paradoxical, if not contradictory. A bit of reflection on the nature of power and institutional development, however, should help elucidate how conflicts of interest not only persist, but also form some of the foundational structural features of any modern political economy. Protean in manifestation, they can and do emerge in a multitude of relationships and institutional forms, both public and private. Upending the comforting simplifications of neat linear relationships among variables, equilibrium theories, and theories of path dependence, conflicts of interest are dynamic relational and institutional forms that are not merely self-reinforcing but also capable of generating feedback loops producing transformative agglomerations of power. Accordingly, they can grow and spread in scale, scope, ubiquity, and destructive impact. That is why they are so potentially dangerous—and thus so important and worthy of special attention in political, economic, and legal theory. It is also why they are the subject of so much empirical investigation and research, institutional design, and post hoc law enforcement. As an intellectual matter, conflicts of interest undermine theoretical frameworks built upon linear causal relationships and functional analysis. The power dynamics cultivated and unleashed by conflicts of interests, especially when they become linked into more complex self-reinforcing networks, display neither linear nor functionally-driven developmental patterns (unless the core institutional function driving the functionalist analysis is specified as self-reproduction and rent extraction).

The constitutive, systemic, and potentially transformative character of conflicts of interest is often neglected, if not completely ignored, in the sprawling and multifaceted literatures on the subject. They are typically framed particular forms of corruption and principal-agent problems, whether political or economic, public or private, within discrete institutional relationships and settings (e.g., political representation, regulatory and bureaucratic processes, corporate governance structures and practices, financial market and contracting failures, and the norms governing professions such as law, accounting, and medicine). Within the public sphere, there is a burgeoning of law and regulation pertaining to governmental corruption focusing on conflicts of interest. In the private sphere, the extraordinary growth in the salience and policymaking in

the domain of corporate governance, particularly with respect to issues of shareholder rights in the face of managerial principal-agent problems, revolves around the conflicts of interest inhering in the corporate form. In this framing, conflicts of interest are serious problems, but ones on the margins of the established political economic order rather than at its core. Yet, as much of the world has succumbed to economic and political crisis, we see ever clearer—and ever more troubling—evidence of the growth, proliferation, and systemic inter-linkages among of conflicts of interest all around us. These conflicts of interest no longer appear as peripheral phenomena, but as core structural features of finance capitalism that has come to characterize the contemporary American political economy.

Increasingly complex, intertwining, mutually reinforcing conflicts of interest are at the root of many of the most fundamental and consequential developments of our age, including the rise of neo-liberalism and contemporary finance capitalism, and their culmination (so far) in global financial collapse, political dysfunction, and deepening legitimacy crises spreading around the world. The idealistic conception of the virtuous cycle of growth and development, facilitated by complementary institutions that help solve collective action and coordination problems, remains the conceptual core and practical aspiration (or conceit) of modern economics, politics, and policy. The world in which we actually live increasingly appears as a perverse inversion of this Panglosian conception of political economic order, as relations and dynamics of efficient economic production mutates into the efficient production and reproduction of power for extractive purposes. Conflicts of interest may be the defining structural characteristic of our age, of neo-liberalism in its decadent phase, displacing the austere utopian vision of the market that served as neo-liberalism's organizing and legitimating trope. Accordingly, a deeper understanding of conflicts of interest from the vantage point of power relations is a precondition for effective political and economic reform.

This paper presents a preliminary exploration of conflicts of interest as constitutive constellations of power by combining the analytical approaches and insights of comparative law and institutional theory. This treatment of the subject does not purport to develop a universal theory or comprehensive treatment of conflicts of interests in their protean and manifold forms. Rather, it seeks to develop theoretical framework to aid in the analysis of the most systemically important conflicts of interest, and to elucidate their structural characteristics and dynamics of self-reproduction and proliferation. The second part of the paper covers some basic definitional and conceptual issues pertaining to conflicts of interest, along with a critique of how they have been addressed in law and legal theory. The third section begins with a discussion of how legal theory and institutional theory can complement one another, and then draws on institutionalist treatments of feedback effects to the theorization and analysis of institutionalized conflicts of interest. The fourth and final section of the paper sketches an application of this institutional theory of conflicts of interest to the origins of the global financial crisis in the American mortgage and securitization bubbles that were enabled and fueled by pervasive conflicts of interest throughout the financial sector and financial regulatory regime.

II. Problems of Conceptualization and Definition

When grappling with the problem of defining conflicts of interest, one may be tempted to invoke Justice Potter Stewart's infamous statement written in frustration with the U.S. Supreme

Court's fumbling efforts to define pornography, "I know it when I see it."[1] Conflicts of interest simultaneously appear obvious and conceptually slippery; they are readily discernible in practice but devilishly difficult to capture within a clear, comprehensive, and coherent definition in theory. Conflicts of interest are intuitively identifiable, yet try to pin down a reasonably precise definition and one is confronted with conceptual complexity often shrouded in normative and empirical ambiguities.[2] Political, legal, and economic theorists confront both empirical and normative difficulties in the conceptualizing and defining of conflicts of interests. Encompassing the wide variation in the forms and instances of conflicts within a given political economic system proves a daunting task, let alone reconciling the divergent analytical and normative framings generated by policymakers, jurists, and theorists laboring under widely varying political, economic, and cultural conditions.

This is not merely a problem of trying to map simplifying conceptual schema and simple definitions onto the complexities of empirical reality. There are certainly technical and analytical difficulties in fashioning an elegant, parsimonious conceptual framework that yields a clear definition and typology (or taxonomy) of conflicts of interest that is at once empirically accurate, comprehensive, analytically illuminating. But the absence of consensus over a common definition and conceptual framework reflects deeper normative, ideational, and at times ideological conflicts over what constitutes a conflict of interest, whether they are inherently bad, and the means by and degree to which they can—or even should be—regulated or eliminated.

The OECD, along with other multilateral organizations has displayed a growing interest in promoting improved governance in both the public and private sectors, and in particular the reduction of corruption. Accordingly, conflicts of interest figure prominently in the OECD policy agenda and reform efforts. Evincing the organization's primary concern with governmental corruption, the OECD's general definition states that, "A conflict of interest involves a conflict between the public duty and the private interest of a public official, in which the public official's private-capacity interest could improperly influence the performance of his/her official duties and responsibilities." (OECD 2003, p. 4) Clarifying this definition, the OECD notes that, "The fundamental idea is that where there is, in fact, an unacceptable possibility of conflict between a public official's interests as a private citizen (private-capacity interests) and their duty as a public or civil servant (official duty), a "conflict of interest" can be said to exist." (OECD 205, p. 13) I use the OECD definition not because it is particularly good or bad, but because it is clear and so typical of those found in laws, regulations, and policy statements (private sector conflicts simply substitute private positions for the term "public official," so long as an "official duty" attaches to the position).

Erhard Friedberg, a sociologist, articulates a more nuanced and theoretically sophisticated version of what he calls the "restrictive" or "pure" definition of a conflict of interest as a situation in which, "an individual entrusted with a certain mission in a certain sphere of action (and certain interests associated with it) will peddle the authority (and discretion) granted to him and the resources available to him for that reason (information, access, etc.) in this sphere to gain

---

[1] *Jacobellis v. Ohio*, 378 U.S. 184 (1964) (Stewart, J., concurring).

[2] *See generally*, Peters, Anne, "Conflict of Interest as Cross-Cutting Problem of Governance," in Anne Peters and Lukas Handschin, eds., *Conflict of Interest in Global, Public and Corporate Governance* (Cambridge and New York: Cambridge University Press, 2012).

advantage, obtain control and influence in another sphere of action." (Friedberg 2012, p. 40) This conceptualization integrates actor-centric and institutional dimensions of conflicts of interest, which require the "explicit and conscious exploitation of information and resource asymmetries gained through the fact of being placed in a position at the intersection of two interdependent and nonetheless conflicting spheres of action and interest." (Ibid. p. 41)

Friedberg argues further that the "pure" definition remains too narrow and that a more fully encompassing definition must include not only *conflicts of* interest (as defined above), but also *conflicting interests*, in order to capture and "emphasise the generality of the fact that there are structural positions that are rife with 'conflict of interest' because they are at the confluence of conflicting spheres of action generating conflicting interests." (Ibid. pp. 40-41) In Friedberg's view, "[b]lurring the artificial distinction between 'conflict of interest' and positions at the confluence of 'conflicting interests' draws attention to three key elements" implicit within the phenomena: (1) the existence of different and intertwined and/or interdependent spheres of action; (2) the "bridging, brokering, or coordinating" by intermediating actors participating in multiple spheres; and (3) a "set of opportunities for action" that allow the capacity for "the (discretionary) use of resources drawn from one sphere of action, in order to gain influence in the other"—in short, "undue influence peddling." (Ibid. p. 41) This revised conceptualization and definition has the advantage of elucidating the structural character of conflicts of interest and drawing attention to situational incentives and norms that render the intersection of certain social spheres vulnerable to conflicted actors. Further, the explicit recognition of multiple social spheres punctures the public-private divide that remains embedded and implicit within prevailing conventional definitions. (Ibid. pp. 41-42) Both of these features enable significant advances in understanding conflicts of interest. As argued in the next section, conflicts of interest—to the extent that they matter for purposes of governance and policy—are predominantly, if not inherently, institutional phenomena. These institutionalized conflicts tend to be particularly dangerous and damaging where they bridge the interests and roles of powerful actors in both the public and private spheres.

This definition, however, is too broad in its inclusion of situations of conflicting interests, where "there is no personal interest at stake, but only the choice between conflicting logics of institutional settings, organisational units or activities[.]" (Ibid. p. 42) These situations of *conflicting* interests are certainly conducive to conflicts of interest, but they raise one of the fundamental problems of *representation*, how to mediate or reconcile multiple constituencies and their interests, not necessarily a *conflict of* interest. An actor, a legislator or corporate manager for example, may favor the interests of one constituency or stakeholder group over those of other competing interests without manifesting of conflict of interest. But if that same actor favors one group's or individual's interest in order to create personal advantage, such as entrenchment of position or maximization of power, a problem of representation becomes a manifest conflict of interest.[3] Accordingly, for purposes of this paper, conflicts of interest require, at a minimum, the

[3] This is a common and deeply problematic characteristic of complex institutions and organizations, and it gives rise to perhaps the most intractable (what Friedberg calls "potential") conflicts of interest. Advocates of shareholder primacy in corporate governance, for example, criticize stakeholder theories, which recognize the legitimacy and necessity of balancing multiple constituency interests in firm governance, as raising the problem of "too many masters." According to this critique, stakeholder theory arguably renders fiduciary duties useless as constraints on managerial authority, as virtually any decision,

presence of a personal interest on the part of an actor exercising discretionary authority (i.e., the conflicted party).

The conceptualization and definition of conflicts of interest requires one additional clarification. The definition advanced above is structural and functional in character. This is in contrast with the more conventional OECD definition's prominent inclusion of explicit (though highly ambiguous) normative criteria, with its references to "official *duties*" and "*unacceptable* possibility of conflict." (emphasis added) This structural and functionalist definition is appropriate for institutionalist theory and analysis, but any consideration of the juridical treatment of conflicts of interest must include this normative dimension, whether framed or derived from civil service and government ethics, fiduciary duties, professional responsibility, etc. For structural and institutional purposes, a conflict of interest may certainly exist without any recognition of a duty (or correlative right) at issue. But a legal conflict of interest necessarily includes a duty or obligation owed by the conflicted actor, which presupposes *political* recognition of this normative criterion through lawmaking and adjudication. In fact, the gap between institutionalist and legal conceptions of conflicts of interest tells us much about the state of politics and allocation of power within it as it does about the conceptual character of conflicts of interest. Conflicts of interest, in the institutional sense, may involve no violation of legal rules or norms. They are no less consequential and pernicious for that; in fact, they may be more so in being insulated or sanctioned by law.

III. Conflicts of Interest as Institutional Phenomena

A. Conflicts of Interest as Constitutive Sources of Power & Institutional Structure

Conflicts of interests are a characteristic malady of modernity. They are prevalent throughout many areas of social life and become nearly ubiquitous as social, economic, and political relations scale up and become more complex. Indeed, modes of legal and institutional control of conflicts of interests may be viewed as a core characteristic of modern societies and developed political economies. In contrast, in less economically developed and more traditional societies conflicts of interest are less likely to be the object of law, regulation, and formal enforcement processes, because of the entrenchment of less formal mechanisms of corruption and governance, and due to the rule of law's often parlous and ineffectual state in developing countries. This suggests that law and formal enforcement processes may provide useful and revealing sources of data when studying industrialized countries with highly developed legal systems and institutions. (*See generally* Cioffi, 2010, chaps. 1 & 2) However, as discussed below, this does not necessarily mean that conflicts of interest are less central in the constitution, organization, and functioning of modern, developed political economies. Indeed, legal rules play a crucial role in creating and institutionalizing conflicts, as well as in regulating them. The constitution and containment of conflicts of interest via law and regulation may be two sides of the same coin.

---

no matter how self-serving, can be rationalized with reference to some constituencies' interests. Politicians' support for policies such as de facto suppressive voter ID laws or unlimited and opaque corporate spending on campaigns are likewise driven by elected officials' self-interest in re-election and the personal benefits bestowed by partisan advantage.

The proliferation of conflicts of interest is, in part, a consequence of the increasing division of labor and functional specialization that are among the essential attributes of modern societies. Friedberg observes that, "the higher the social differentiation in our societies, the more different interests originating in different spheres of action have to be reconciled, articulated and coped with in interface management." (Ibid. p. 41) Specialization, technical expertise, and professionalization have driven the spread and magnified the importance of conflicts of interest, as increasing complexity and interdependence of social, economic, and political institutions have generated a vast array of relationships characterized by hierarchy, representation, gate-keeping, and/or dependence on the expert judgment of others. Delegations of power and authority, deference to technical or professional expertise, and dependency on these forms of expertise become commonplace and inevitable, even as these relationships foster information asymmetries, monitoring and accountability problems, and at their foundation a divergence of material or normative interests among those implicated in the webs of these types of relationships. The global financial collapse of 2008-2009, for example, cast a harsh but illuminating light on the proliferation and destructive impact of conflicts of interest within both the public and private spheres, and—crucially—the conflicted relationships bridging these spheres. Yet, our understanding of such conflicts remains in many ways superficial and inadequate given the threat they present and the damage they have unleashed.

In their most consequential manifestations, *conflicts of interests are institutional phenomena defined by an institutionalized structure of power relations that endow an actor or class of actors with organizational authority and control for the ostensible benefit of third parties*. This institutional definition has two components: (1) the autonomous, institutionally-defined power of an actor, and (2) a beneficiary's dependency on and vulnerability to harm via the exercise of that power. Conflicts of interest may be viewed as transactional, of course. For example, on may conceive as merely transactional a particular bribe paid to a public official to secure specified favorable treatment[4], or investment bankers using informational asymmetries to fleece client-investors or (arguably) other market participants in complex securities transactions arranged by the bank.[5] However, the specificity of this transactional framing obscures the most important dimension of most, if not all, conflict of interest situations. These specific transactions are embedded in an institutional context that grants an actor discretionary authority and judgment within an institutionally defined role that encompasses an actor's conflicting interests, simultaneously defined egoistically and with respect to the interests of another whom the actor is supposed to serve.[6]

As institutional phenomena, conflicts of interest pose a disturbing and unstable double paradox. First, even as they often concentrate power and insulate hierarchies from

---

[4] The Supreme Court in the *Citizens United* decision notoriously limited the conception of "corruption" that can be invoked as a justification for campaign finance regulation to this narrow transactional sense of quid pro quo bribery, thus dramatically restricting the constitutionally valid grounds for and scope of campaign finance law.

[5] This was a core allegation against Goldman Sachs in the bank's deceptive sales of mortgage-backed securities designed to default and related derivatives that paid off as a result.

[6] For simplicity's sake, I treat institutional (or organizational) interests, such as those of a bank, firm, or regulatory agency, as individual (or egoistic) interests. The reality of institutional interests, and thus institutional conflicts of interest, raise additional conceptual, practical, and legal difficulties that need not detain us here.

accountability, conflicts of interest are the source of increasingly pervasive and corrosive distrust of power and hierarchical institutions. Second, although often constituted by law via the juridical underpinnings of institutional arrangements, conflicts of interest produce asymmetries of power and normative contradictions that tend to undermine both the legitimacy and ultimately the functionality of the rule of law. Prevailing legal theory and doctrines pertaining to conflicts of interest frame them, explicitly or implicitly, as pathological and extractive. In short, whether viewed through the normative lens of anti-corruption law, fiduciary obligation, or principal-agent theory appropriated from neoclassical economics, conflicts of interest are conceived as deviations from the norm of otherwise functional political or economic relationships and institutional arrangements—to be minimized and policed, if not prevented or eliminated entirely. However, conflicts of interest are not merely unfortunate incidental byproducts or unintended flaws and pathologies within modern political and economic institutions. They are often actively cultivated and legally constructed by protagonists in political conflicts over the prevailing institutional forms of political and economic life. And these conflicts are most intense with respect to struggles over the powers and structural elements of the most consequential institutional forms, including the constitutional framework of the state, legislatures, executive departments and regulatory agencies, courts, political parties, financial institutions, corporate firms, or complex markets.

As suggested above, however, conflicts of interest are, in many of their most consequential instantiations, *constitutive of* institutional architectures and power relations. Given their capacity to concentrate power and resources, it hardly is surprising that actors and groups seek to create and cultivate conflicts of interest for their own benefit. Further, where institutionalized conflicts of interest emerge and begin to concentrate political or economic power, they should bias processes of institutional development to favor those already advantaged by these existing institutional arrangements. In the politics of conflicts of interest, the monitoring and constraint of abuses of power and trust are secondary. The primary dynamic, and concern, is “the conscious and explicit creation of barriers to generate information and resource asymmetries” through “strategic action involved in creating and looking for positions characterised by potential conflict of interest[.]” As Friedberg insightfully notes, “this is precisely what makes them interesting: conflict of interest can be a constraint, but most of the time it will also be experienced as an opportunity and as a resource.” (2012. p. 42) Consequently, conflicts of interest are inherent and constitutive structural characteristics of all forms of political economic order, even as their specific instantiations along with the means of creating and constraining them vary across time and space. But this creates, from the perspective of mainstream social science, something of a causal conundrum in which institutional contexts constitute conflicts of interest, while conflicts of interest—as forms of power relations—constitute institutions and their inter-linkages. The bi-directional causation and endogeneity of the causal relationships implicated by conflicts of interest and processes of institutional development are obvious. However problematic this may appear from the standpoint of much positivist social science, theories of endogenous, self-reinforcing feedback effects are ideally suited to the study of these types of dynamic relationships, and they may offer a way to explain why political and economic life is shaped so disproportionately by institutionalized conflicts of interest.

Whether they are intentionally and deliberately cultivated, or simply the stubbornly resilient accretions born of historical contingency, *conflicts of interest in their institutionalized form share the common and critically important characteristic of self-reinforcement through functional and distributional feedback effects*. These positive feedback effects endow institutionalized conflicts of interest with their most vitally important attribute, and the key to their perpetuation and constitutive force: *the tendency to generate accumulations of concentrated power*. These growing concentrations of power within certain institutional forms intensify the very conflicts of interest built into the institutional architecture as the increasingly powerful occupants of these privileged positions recursively exploit and reinforce the flaws of their structural design. As this logic of institutionalized conflicts of interest plays out, this institutional architecture and the entrenchment and interlocking character of institutionally defined and empowered groups become defining structural features of the broader political, legal, and economic landscape. Put another way, conflicts of interest are not deviations from or malfunctions of the rules of the game in political and economic life; in many instances they *are* the game.

Viewed as part of the essential institutional architecture and rules of the political economic game, conflicts of interest suggest an implication of E. E. Schattschneider's famous dictum that "new policies make new politics." (Schattschneider, 1935: 288) If actors and groups seek to maximize their own power and wealth, they should actively seek to construct, cultivate, and entrench conflicts of interest that empower them, as they are particularly effective ways of maximizing both. Whether conflicts are generated as unintended consequences or deliberately constructed features of policies, laws, or legally enforced institutional arrangements, conflicts of interest generate power. These power resources enable their beneficiaries to not only fend off threats to these conflicts of interest, but to also seek to leverage their power in policy and law making processes to further expand their power and privilege—including by means of expanding or proliferating conflicts into new areas and political economic relations. Accordingly, far from being a marginal phenomena subject to legal constraints, conflicts of interest—especially in their most important and consequential manifestations—are often are *created by, enshrined in, and enabled by law*, and their near-ubiquity across time, space, and social context makes them empirically and historically *unexceptional*.

This institutional and systemic perspective has theoretical and practical implications for our understanding and juridical treatment of conflicts of interest. The problem and means of addressing conflicts of interest pervade many areas of law in modern societies, from the law of contracts, torts, professional responsibility, fiduciary duties, and corporations, to the legal treatment of public corruption, civil service administration, and campaign finance, to administrative and constitutional law. One obvious reason for this is that conflicts of interest take innumerable forms and law, as a practical instrument for the ordering of human affairs, cannot address or even define all their instantiations with sufficient precision within a single uniform and universal, economic, political, or legal theory, let alone a single comprehensive set of legal rules. Consequently, the policy and legal treatment of conflicts of interest in law and regulation tends to highly fragmented and particularized, pragmatically tailoring their definition and regulation to specific forms and contexts.

A second fundamental reason for the fragmentary and piecemeal treatment of conflicts of interest under law is more interesting and revealing for present purposes. In law and legal discourse, conflicts of interest are commonly conceived as exceptional, rather than the norm endemic to many relational and institutional contexts. They are framed as incidental pathologies or unintended and marginal defects in institutional (or contractual) design. This predominantly uncritical framing of conflicts of interest should come as no surprise, given that law either constitutes or formally recognizes and reinforces extant structural and relational features of the political economic order. The largely conservative bias and function of law lends itself to the perpetuation and legitimation of prevailing power relations, including those generated by conflicts of interest—especially when not classified and regulated as such.

These twin tendencies towards marginalization and juridical fragmentation also can be seen in the way law and regulation compartmentalizes conflicts of interest within either the public sphere (e.g., governmental corruption, agency capture, or structural features of constitutional design) or the private sphere (e.g., principal-agent problems afflicting market or firm governance, or professional standards of conduct) and further subdivides them into more specific institutional or professional spheres of action. Bodies of public law pertaining to corruption and maintaining the appearance of impartiality, etc., narrow the scope of conflicts of interest as they are defined and regulated, while often defining many problematic relationships as non-corrupt by the dubious virtue of falling outside the legal definitions of impermissible conflicts or corruption.[7] For example, despite the seemingly endless proliferation of conflict of interest and anti-corruption laws, the corrupting influence of unrestricted corporate and private money in political campaigns in the United States has been ruled beyond the narrow confines of "quid pro quo" corruption of the political process and perversely enshrined as a constitutional right under the First Amendment.[8] Within the private sphere and the paradigm of neoclassical economics, conflicts of interest tend to be conceived as contracting failures (if they are seen as failures at all), rather than as more complex and dynamic institutional structures and power relations, best remedied by voluntaristic contractual mechanisms and market pressures. From this perspective, structural failures of corporate governance and financial markets are not political but economic in origin; state intervention through law and regulation should remain minimalist in order to leave maximum latitude for market-driven adaptation and transactional responses.

This bifurcation of public and private, along with underlying the fragmented and particularistic way in which conflicts of interest are commonly conceived and addressed in theory and policy, misses some of the most consequential dimensions of conflicts as institutional phenomena and sources of political economic power. The prevailing formalist and technocratic

---

7 For a compendium of state-level conflict of interest laws covering public officials in the United States, see National Conference of State Legislatures, Conflict of Interest Definitions, u**pdated April 2013,** available on line at http://www.ncsl.org/legislatures-elections/ethicshome/50-state-table-conflict-of-interest-definitions.aspx.

8 Compare Gash and Trost, 2008 (discussing the proliferation and expansion of conflict of interest regulation), with *Citizens United v. Federal Election Commission*, 130 S.Ct. 876, 908 (2010) (narrowing the permissible grounds for curbing corporate and other private spending on political campaigns to the prevention of "quid pro quo" corruption, the exchange of money for favorable legislation and other governmental treatment).

framings and treatments of conflicts of interest downplay or miss entirely the relationships among them that bridge or blur the public-private divide. Likewise, they miss how multiple, institutionalized conflicts of interest generate power relations that span and in many ways intertwine the public and private spheres. In short, scholars and policymakers operating within the paradigms of neo-liberalism and pluralism tend to overlook the broader systemic character and deeper constitutive function of conflicts of interest embodied and embedded in the institutional architecture of the political economy.[9]

B. Feedback Effects, Path Dependence, and the Symbolic Politics of Conflicts Law

Paul Pierson's work on feedback effects in politics and political economic development is a useful jumping off point to explore this feature of conflicts of interest. (Pierson, 1993, 2003) Elaborating on Schattschneider's aphorism that "new policies make new politics," Pierson pioneered the theoretical inquiry into the causal role of feedback effects in explaining how policy (and by extension legal) changes can drive politics, rather than vice versa. (Pierson, 1993; Schattschneider, 1935) In his analytical dissection of how policies shape the allocation of power and thus drive the conduct and development of politics, Pierson extends his analysis of feedback effects and increasing returns to scale to explain how these dynamic processes may produce change rather than the stable equilibria predicted by decreasing returns to scale. Yet, Pierson's consideration of these dynamics remains firmly within the rubric of path dependence. The change generated by these feedback dynamics and increasing returns help to explain why some institutions and institutional arrangements prevail over others, but then produce lock in effects that make departures from the established path or trajectory increasingly difficult. As a result, even institutions subject to ongoing processes of evolutionary change (i.e., not locked in a static equilibrium) display pronounced continuity with the past.

Denis Saint-Martin has advanced a provocative analysis of conflicts of interest that draws upon theories of path dependency and their use of feedback effects and dynamics of increasing returns. (Saint-Martin, 2008) Saint-Martin reviews a range of prominent theoretical and empirical explanations for the increasing political salience, volume, prescriptive detail, and scope of coverage of formal legal (along with quasi-legal and informal) rules and norms to prohibit, constrain, or police conflicts of interest. First, neo-Weberian theories of institutionalization purport to explain increased awareness and regulation of conflicts of interest as mechanisms establishing and reinforcing the autonomy of an institution from its surrounding environment, and the bureaucratic rationality of its internal functioning. Conversely, a second set of theories, premised on the erosion of class politics, social capital, and public trust in politics and hierarchical institutions, view the growth and increasing political salience of conflict of interest regulation as a functional mechanism to shore up the parlous legitimacy of political economic

[9] The corporatist political tradition and associated scholarship is far more attentive to the complex institutional relationships among and interpenetration of public and private power. (See Pierson, 1993, 601) However, the literature o corporatism, along with related literatures on national models and varieties of capitalism, has focused on the determinants of path dependent stability and the complementarity of institutions in promoting economic competitiveness and the efficiency-driven self-reproduction of national institutional arrangements. The varieties of capitalism literature, in particular, tends to stress the stability and path dependence of national economic models. (See, e.g., Hall and Soskice, 2001). Sustained attention to power, conflict, and politics is notably lacking in this literature. (See Levy, 2006: pp. 22-26; Cioffi, 2010: pp. 27-28)

institutions in an era of mass disengagement and alienation from politics. Third, another explanatory theory frames this burgeoning area of law and regulation as simultaneously a means by which politicians curry favor with (and shield themselves against blame from) an increasingly distrustful and cynical electorate, while providing them with weapons to attack the ethics of rivals in a emergent for of "politics by other means."

Although each of these general theories has some descriptive and explanatory merit, Saint-Martin finds that they each fail to account adequately for the significant variation across political jurisdictions and institutions, and for the (allegedly) inefficient hypertrophy and other excesses of conflicts regulation. He argues that theories "feedback effects" and "increasing returns" appropriated from institutional theory, particularly those developed by Paul Pierson (e.g., 2003), help to account for both variations across cases, and the dynamic of recursively expanding conflict of interest regulation. Saint-Martin contends that where politicians adopt conflicts regulation in a given institutional setting, whether as a response to popular demand, legitimacy problems, electoral pressures, and exigencies of partisan conflict, the initial choice of this form of regulation initiates a feedback effect in which future responses to any of these problems and pressures are increasingly likely to take the form of further conflicts regulation. Accordingly, the proliferation and seemingly ceaseless expansion of conflicts regulation is a path dependent process that describes distinctive trajectories of legal and regulatory development. In studying cross-national variation in the development of conflicts of interest regulation, Saint-Martin places the subject squarely at the nexus of comparative law and comparative politics. In framing his analysis and explanation in terms of feedback effects, he sketches out a way to integrate comparative law and historical institutionalist theory that holds the promise of fruitful cross-pollination and, better yet, hybridization of both fields. Summing up the argument, Saint-Martin concludes:

> As a result of . . . increasing returns processes, path dependency theory tells us that politicians will keep adopting more ethics rules because: (1) this is the proper thing to do in a democracy; (2) it is politically difficult to be against more ethics; (3) ethics rules provide easily accessible resources for political combatants; (4) they provide symbolic reassurance against misconduct; and (5) they are cheap to adopt because enforcement is weak. . . . Combined together, 1 to 5 act as self-reinforcing processes. They create a feedback loop that makes it difficult for political actors to switch to another alternative.[10]

To push this argument further, conflicts of interest regulation has become an increasingly prominent legitimation mechanism deployed by political and professional elites to counter public perceptions of political systems growing more insular, unresponsive, unaccountable, and corrupt. According to this logic, politicians should adopt conflict of interest standards and regulations with greater frequency and with higher visibility as these public attitudes become more widespread and pronounced. Rather than a steady improvement in the quality of governance, the growth of conflict of interest regulation serves as Kabuki theater scripted and enacted repeatedly in response to the secular erosion of legitimacy and public trust in the power of and conduct within public and private institutions. And this erosion is, at least in part, the product of deeper,

[10] Saint-Martin, 2008, p. 55 (quoting Wood, 2001, p. 374) (internal citation omitted, emphasis in original).

more fundamental conflicts of interest left largely—if not entirely—untouched by the symbolic politics represented by this legal and regulatory bloat.

In light of recent the crucial and immensely destructive role played by conflicts of interest and "criminogenic" institutions (to adopt William Black's term), to focus on the allegedly excessive and inefficient conflicts regulation, despite the (entirely reasonable) assumption that enforcement is and will remain weak, is to miss the main narrative of recent political economic developments, and why conflicts of interest are so critically important at this historical juncture. However, the focus on the arguably excessive proliferation of conflict of interest regulation ignores a massive and destructive rising tide of elite looting and criminality to focus on the legislative and regulatory flotsam and jetsam on its surface.[11] The important questions raised by conflicts of interest are not merely their persistence, nor mushrooming proliferation of regulatory attempts to police their periphery, but their role as foundational sources of power in the political economic order and their consequent potential to alter the developmental path of institutional change. The central theoretical and practical concerns raised by conflicts of interest across the industrialized countries in recent decades pertain to the proliferation and accelerating infiltration of conflicts of interest throughout the public and private spheres, along with their corrosive impact on governance and contribution to resultant political economic crises.

C. Conflicts of Interest and Institutional Change

More recent research and theoretical work seeking to understand processes of institutional change have tended to develop descriptive ideal typic categories without developing theories of the micro-foundations or macro-politics of change. (See generally Streeck and Thelen, 2005, cf. Campbell, 2004) Moreover, much of this literature remains preoccupied with and well within the theoretical paradigm of path dependence, seeking to reconcile evidence of institutional and policy change with the alleged stability of political economic models. (See generally Pierson, 2003) Much of this recent institutionalist work seeks to move beyond theories of punctuated equilibrium in which prolonged periods of stability are broken by exogenous shocks that produce rapid and substantial institutional and policy changes, in order to identify and examine the processes of more continual incremental change that characterize complex social systems. However, conflicts of interest as sources of potentially destabilizing and transformative power have remained peripheral, and most often invisible, within the theoretical frameworks of path dependence that dominate historical institutionalism and (the "new") institutional economics. Yet studying the architecture of conflicts of interest may hold much promise for understanding endogenous destabilization and change that are increasingly evident across the industrialized countries.

---

[11] The alleged excesses of conflict of interest regulation is not an idiosyncratic preoccupation of Saint-Martin's. This is the overarching argument of the volume in which his piece appears (Trost and Gash, 2008) and Andrew Stark's (2000) book, *Conflicts of Interest in American Public Life* (perhaps the most influential social science monograph on the subject in recent decades). These works bear a family resemblance to the literature on over-regulation, juridification, and the American "litigation explosion." For a critique of this broader literature on legal excesses, over-regulation, and litigation, see McCann and Haltom, 2004.

Hacker and Pierson's (2010) analysis and fierce critique of the rise and consequences of American neo-liberalism in *Winner-Take-All Politics* hint at the centrality of conflicts of interest in their focus on the structural bases of political and economic power—and the interactions between them—particularly in their emphasis on the rise of finance and financialization. They trace the transformation of power relations and public policy since the 1970s and the way these changes have generated a set of self-reinforcing institutional arrangements and political dynamics that increasingly concentrated power, wealth, and income. One should note the striking shift from the preoccupation with path dependence in Pierson's *Politics in Time* (2003) to the dynamics of destabilization, transformation, and political economic crisis in *Winner-Take-All Politics*. The proliferation of conflicts of interest and their increasing virulence spanning the public and private spheres abound throughout their analysis of the soaring inequality and political economic dysfunction in the recent American history. These pathogenic conflicts of interest were not merely instrumental in the emergence of American finance capitalism; they were and are constitutive of it. This proliferation of conflicts ultimately coalesced and culminated in the mortgage debt bubble, the global financial crisis, and the Great Recession.[12]

Despite his emphasis on path dependence and growth of ineffectual regulation, Saint-Martin notes that politics may escape the inertial tendencies of path dependence:

> [T]he *authoritative* nature of politics . . . offers opportunities for changes in direction. . . . "[T]he *concentration of political authority* in political contexts means that the interests of the few may dictate the fate of policies that apply to all." The key theoretical point here is that when the costs of the perceived inefficiency of certain policy trajectories are *concentrated* among those who have access to policymaking powers or to significant political resources, changes in policy are always possible.[13]

That "key theoretical point" can be inverted and be put to better use in explaining how inefficiencies that concentrate benefits among powerful, resource rich political actors and groups can generate political and policy feedback loops that magnify those inefficiencies and their attendant benefits for the privileged and extractive few. These feedback dynamics, far from producing a surplus of ethics and conflicts regulation, would ultimately have a transformative and catastrophic impact on the political economy of much of the developed world in the genesis and contagion of the global financial crisis of 2008-2009 and now in chronic political economic crisis in its aftermath. As sketched out in the brief review that follows, the few would reap vast benefits and dictate the fate of policies that would, for the most part, preserve their privileged status while imposing their enormous costs on all. An examination of the American roots of the

[12] Wolfgang Streeck has also taken exception to this emphasis on path dependence and stable trajectories of development. (Streeck, 2005, 2010; cf. 2009, 2016) His critique of German neo-corporatist associational bargaining as increasingly dysfunctional points to the collusive and self-serving use of institutional power by large employers and organized labor to retain the economic benefits of the Germany's highly competitive form of sectoral organization while externalizing onto the state and broader public the rising costs of rising unemployment, stagnant incomes, and curtailed consumption. Although he does not develop a sustained analysis of the political economy of conflicts of interest, or the constitutive role they play in the rise and crisis prone character of contemporary finance capitalism, his astute identification of the extractive and corrosive potential of conflicts of interest within the institutional arrangements of the German model is consistent with perspective developed here.

[13] Saint-Martin, 2008, p. 55 (emphasis in original).

global financial crisis demonstrates and clarifies the central and constitutive role played by institutionalized conflicts of interest in the structure of the political economy and its seemingly intractable crisis.

IV. Conflicts of Interest and the Crisis of Finance Capitalism

A stylized discussion of the complex financial, regulatory, and political machinery that produced the economic disaster of the global financial crisis and ensuing Great Recession elucidates the ubiquity and centrality of conflicts of interest in the constitution and governance of the political economy.[14] Figure 1 traces the "circuit" of relationships and financial transactions that produced the U.S. real estate and mortgage debt bubble, which in turn triggered the global financial collapse of 2008-2009.[15] Figure 2 illustrates the conflicts of interest that pervaded the securitization circuit and allowed it to grown almost incomprehensibly oversized and destructive. Yet another layer, or level, of conflicts of interest within the political and regulatory systems, at times admixed and legitimated by neo-liberal ideology, produced a near perfect record of policy and regulatory failures that allowed, even aided, the securitized debt bubble to reach catastrophic proportions.

Figure 1: The Mortgage Securitization Cycle—Securitization and Distribution of Subprime Mortgage-Backed Securities (MBS)[16]

None of the parties linked in the securitization web acknowledged the dangers of a financial crash posed by an increasingly obvious real estate bubble. Some never were aware of or understood them. Many maintained self-deluded sense of confidence and security based on faith in bond ratings, the oft-proclaimed risk-spreading properties of derivatives, or the "quants'" impenetrable mathematics that endowed the financial alchemy of securitization with veneer of intellectual rigor. Some, including many of the mortgage originators, investment bankers, and hedge fund managers, appeared indifferent to the growing risks and adopted a ruthless short-term perspective and sought to extract maximum profits before the inevitable collapse. Many of the most sophisticated and powerful parties in the securitization cycle, especially the investment bankers, ratings agencies, and hedge funds, were well aware of the risks, but opportunistically exploited the conflicts of interest and information asymmetries within the complex tangle of counterparty relationships.

[14] This is not the place for a more detailed review and analysis of the causes and consequences of the rise of finance capitalism and the global financial crisis. For a more detailed discussion and analysis of the intertwined financial, regulatory, and political dimensions of American finance capitalism and the financial crisis, *see* Cioffi, 2012; 2010, chap. 6.

[15] See Cioffi, 2012. Note that this securitization circuit existed before the real estate and securitized debt bubbles, and still exists. The cycle itself, in the absence of the systemic pathologies analyzed here, was the beneficial and long benign product of the New Deal and decades of subsequent federal housing policy and financial regulation.

[16] Source: Cioffi 2012.

A. The Securitization Cycle as Transactional Circuit

Subprime Mortgage Lending and Securitization

The securitization circuit began with mortgage originators lending funds to home borrowers. The lenders immediately sold these loans to investment banks (the arranger), to be pooled and securitized. "Sub-prime" mortgages to riskier borrowers were actually more desirable because they returned higher interest rates. The banks bundling these home loans together securitized them by dividing cash flow rights to future mortgage payments into "tranches" of mortgage-backed securities (MBSs). These tranches were defined by seniority of their cash flow rights vis-à-vis other tranches. Tranches with lower seniority (or cash flow priority) posed higher risks of default, and thus received lower bond ratings and paid higher interest rates. These lower tranche MBSs, often rated at high-risk "junk" status were then pooled again, their cash flows re-partitioned once again into tranches of collateralized debt obligations (CDOs). Once again, the senior CDO tranches rated AAA. At each stage of securitization, the ratings agencies rated the "senior" tranche, usually over 80 or even 90 percent of securities created, as AAA, indicating they were as safe as U.S. Treasury bonds (virtually risk free).

Investment Banking, SIVs, and Leverage

The investment banks moved the MBSs and CDOs off their books by creating highly leveraged "special purpose vehicles" SPVs called "structured investment vehicles" (SIVs) and "conduits," nominally independent shell corporations or trust entities, to purchase the securities and then sell them on to investors.[17] These contingent liabilities grew at an accelerating rate as the SIVs and conduits retained the most risky and least desirable securities—those even the least risk-averse investors refused to buy—and became vessels for accumulating "toxic debt." These entities financed their securities purchases (long-term assets) through heavy short-term borrowing. This resulted in highly leveraged, unstable, and thus risky capital structures that are extremely profitable as long as financing is plentiful and cheap, but acutely vulnerable to any disruption of their massive short-term borrowing. These entities were primed to default if rising credit costs (short-term interest rates) or curtailment of lending left them unable to continue financing their debts.

The SIVs and conduits were legally separate from the bank for purposes of accounting and financial disclosure under securities laws, but they remained very much linked in that the arranging banks remained liable to finance these entities and take their unsold securities back on their balance sheets in the event of default. These retained securities tended to be the most risky, and thus the most unmarketable, tranches of the banks securitizations. They accumulated over the course of the bubble, yet the banks rendered them invisible by moving these "toxic" securities off of their balance sheets and into SPVs. Also largely invisible was the risk of these securities flooding back onto the banks' balance sheets in the event of a financial crisis and mass mortgage defaults. But in the meantime, the banks' finances looked far more secure than they were, ensuring soaring profits, stock prices, executive compensation, and the capacity to

[17] The banks also engaged in second-order securitizations by bundling lower tranches of multiple CDOs into another SPV and marketed them as an even more complex, opaque, and highly leveraged "CDO squared."

perpetuate the securitization cycle that fueled the real estate and debt bubbles.

Credit Default Swaps

Credit default swaps (CDSs) exponentially amplified and prolonged this expansion of leverage and systemic risk. In the guise touted by advocates of neo-liberal financial innovation, these derivatives (securities whose price is based on the price of other securities) served as a form of unregulated insurance on securitized debt instruments, including MBSs and CDOs. The seller of CDS protection is obligated to compensate the buyer for the loss of the underlying securities' value in the event of default or other contractually specified conditions in exchange for regular cash payments. In theory, the transaction shifts risk from one party to the other, facilitates the spreading of risk to those more willing and able to bear it, and enhances the stability of financial markets. In the absence of any meaningful regulation, however, this happy story of economic theory was turned on its head. First, the value of CDSs issued by financial institutions exceeded the value of 'covered' MBSs and CDOs by a factor of ten, as derivatives became a predominant means of financial speculation rather than hedging and risk spreading.[18] Second, absent any disclosure and transparency regulation, or even a regulated exchange for their trading, no one knew who held CDSs or in what amounts. The excessive issuance of CDS vastly increased the net risk and loss exposure throughout the global financial system; the lack or transparency made assessing risks impossible while enabling reckless financial managers to *concentrate* risk by retaining huge holdings of—and thus loss exposure to—CDSs. These flaws, taken together, inflated the systemic risk generated by securitization and ever-higher leverage, already historically high, to catastrophic levels.

The Ratings Agencies

The major ratings agencies became the keystone component of the securitization cycle and all that went wrong with it. The seemingly miraculous elimination of risk within the securitization process depended on the assistance of ratings agencies to make the "senior" tranches of each securitization marketable to investors. The Securities and Exchange Commission had recognized the three major ratings agencies, Standard & Poor's, Moody's, and Fitch, as "nationally recognized statistical rating organizations" (NRSROs) since the mid-1970s. That legal status empowered and enshrined the NRSROs as market gatekeepers within a regulatory cartel. Notwithstanding this extraordinarily valuable privilege bestowed upon them, along with the power and responsibilities attendant to it, the NRSROs remained almost entirely unregulated.[19] Their ratings determined the eligibility of securities for purchase by savings and loans associations, credit unions, and federally regulated pension funds. In the case of complex asset-backed complex debt securities, the ratings agencies were pivotal in that these securities were virtually impossible for purchasers to value independently, and banks could only sell them to institutional investors if they received investment-grade ratings. The ratings agencies obliged

[18] For example, if $1 billion in CDOs were covered by $10 billion in CDSs, the net increase in potential losses on the original securities are ten times larger.

[19] This absence of regulation and regulatory oversight is especially shocking given the NRSOs' egregious ratings failures during the stock market bubble of the 1990s. How and why they are still unregulated despite their notorious role in multiple financial crises remains an important question in dire need of further research and analysis.

by using flawed risk assessment models that purportedly confirmed that MBSs and CDOs had transformed high-risk mortgages into virtually risk-free, high-yield securities. With official blessing bestowed by the NRSROs, financial institutions and pension funds could buy the securities, sending more capital and cash flow into the securitization circuit and further inflating the real estate and debt bubbles.

B. The Web of Conflicts and the Politics of Financial Extraction

Each of these steps in the securitization cycle was essential to its own perpetuation and the recursive inflation of a real estate bubble that fueled a massive expansion of credit and leverage within the shadow banking system. If any were missing or ceased to function, the entire self-reinforcing cycle would collapse in a financial crash. Of course, the real estate bubble burst and brought down the entire elaborate machinery of the securitization circuit, along with the global financial system and the economies of much of the developed world. Even during the bubble years, it was astonishing to witness and difficult to grasp the full scope and depth of the financial system's malfunctioning. With the onset of the financial crisis's acute phase in October 2008, the scale, pervasiveness, and depth of financial system malfunction became more apparent and astonishing.

The breadth of and institutionalization of this dysfunction is a key to understanding it. Just as the securitization cycle must be understood systemically, as a circuit of transactions, its dysfunctional and destructive dynamics can only be understood as inhering within a self-perpetuating system of interlocking relationships defined by power relations and information asymmetries. Fundamental to the logic and operation of this system was a highly articulated set of structurally linked and interdependent conflicts of interest that characterize not only corrupt and destructive dynamics of the mortgage securitization circuit, but also those that still plague the political economy of finance capitalism. This web of relationships subject to severe conflicts of interest is sketched out in figure 2 below.

Figure 2: The CDO and CDS Securitization Web—Main Participants and Relationships[20]

Subprime Mortgage Lending and Securitization

As mortgage lending became a volume business in which lenders immediately sold off loans and retained no residual risk of default, originators debased lending standards to generate mortgages for the securitization pipeline. This was more a matter of collusive opportunism with the investment bankers, rather than a conflict of interest between originators and arranging banks. The banks knowingly purchased the infamous "liar's loans" of the bubble years to satisfy their insatiable demand for higher-yielding subprime mortgages to pool and securitize. Conflicts of interest *did* afflict the initial borrower-lender relationship, with mortgage originators

[20] Source: Cioffi, 2012.

manipulating, and often outright defrauding, borrowers into predatory sub-prime loans.[21]

The rampant fraud and widespread abandonment of quality and risk management controls were widely know within law enforcement and banking regulation circles for years as the housing bubble inflated. The Federal Reserve under Chairman Allen Greenspan, responsible for the systemic integrity and stability of the national banking system, refused to intervene to halt these practices in keeping with a rigidly ideological adherence to laissez-faire economics. Other federal banking regulators and the SEC also failed to intervene to curtail misconduct in mortgage lending. In part, the inaction of regulators was ideologically drive, but they were also motivated by conflicts of interest within the regulatory state that were generated by the pressures of interest group politics operating through Congress and the White House, and by competition among regulators themselves for jurisdictional turf and increased 'market share' as measured by the number of banks they oversaw. Most notoriously, the Office of the Comptroller of the Currency encouraged financial institutions to submit to its jurisdiction by holding itself out as the most lenient regulator. For this reason, AIG acquired a savings and loan bank in order to come under the Comptroller's feeble oversight and proceeded to issue—and retain—hundreds of billions of dollars worth of CDSs that made the housing crash and financial crisis immeasurably worse.

Investment Banking, SIVs, and Leverage

As the central intermediaries of the securitization circuit, the investment banks and, in particular, their senior managers engineered or colluded in multiple strategies to exploit multiple conflicts of interest. The bankers were enmeshed in conflicts of interest with respect to investors to whom they sold MBSs and CDOs, and with respect to their own shareholders. And they had decisive advantages in market power and informational asymmetries over both groups. Like the mortgage originators, the arranging investment banks sought to offload and externalize growing mortgage default risks by selling off as many of their MBSs and CDOs as possible, as quickly as possible. In both their creation and marketing of these securities, the banks assiduously hid or misrepresented the true default risks and thus the real loss exposure taken on by their purchasers. They obscured their growing residual loss exposure to these securities through the use of SIVs or CDS hedging, and often marketed securities internationally through off-shore subsidiaries that further shielded them from regulatory oversight and disclosure rules. The SIVs and conduits, although nominally independent, were always the creatures of the banks, created for accounting reasons.

Securities regulation and corporate governance law are the primary means of addressing these conflicts of interest, but both failed to curtail the securitization bubble and its underlying abuses. Because they were privately placed debt issues or (in the case of CDOs, debt-based derivatives), they fell outside the disclosure rules and other regulatory protections of securities law. In the absence of applicable mandatory disclosure rules, and no transparent exchanges on

[21] Note that this is an instance in which the distinction between the legal and functional definitions of conflict of interest is relevant. If the governing law does not recognize some form fiduciary or other borrower-protective duty on lenders, there is no legal conflict. But any reasonable observer would recognize the conflicting interests of lender and borrower, and the vulnerability of the former to the self-interested conduct of the latter. That said, the abuses in mortgage lending became so outlandish that they contravened legal obligations on a mass scale. (See, e.g., Hudson, 2010)

which to trade these securities, investors purchased them in an informational vacuum. Likewise, in the absence of adequate disclosure of material information, corporate governance processes failed even more spectacularly they had during the dot.com bubble less than a decade prior, leaving bank shareholders exposed to catastrophic risks of loss as bank managers extracted skyrocketing levels of compensation based on short-term and often illusory profits. The obscuring of risk and the true financial condition of firms through the use of SPVs like SIVs had been one of the defining features of Enron's collapse following the dot.com crash, and was supposedly addressed by provisions of the Sarbanes-Oxley Act of 2002. Strikingly, those reforms failed to restrain these subversions of financial disclosure rules to any meaning extent.

For decades, financial regulators relaxed capital requirements, limits of leverage, and the long-standing separation of investment banking from traditional—and highly regulated—commercial and depository banking. The banks themselves had undergone a financial transformation of their own after the Federal Reserve dramatically weakened bank accounting standards during the 1990s, and after the banks' successfully lobbying the SEC, with the support of the Fed and the Bush administration, to relax leverage limitations in 2004. The average leverage (debt to equity) ratio among major American investment banks and hedge funds soared from under 10:1 to nearly 30:1 at the height of the real estate and securitization bubble (at which point a 4 percent decline in the value of assets would destroy the equity, and thus the solvency, of the bank). (Tett 2009: 134) This explosion of leverage and risk throughout the financial system was not solely the result of a transformation of finance, but also the product of a long and deliberate process of policy change and regulatory erosion.

It is often difficult to parse out the policy and regulatory changes driven by neo-liberal and *laissez faire* ideology, and those rooted in regulators' conflicts of interest. Much of the Federal Reserve's agenda of deregulation and non-enforcement was clearly a product of ideology, as the Fed has a level of independence and insulation from political pressure and interference that other financial regulators lack. Much of the banking regulators' *de facto* deregulation through non-enforcement of regulatory rules and standards, however, appears to have been motivated by personal and bureaucratic interests in protecting or expanding jurisdiction and turf, including the number of financial institutions under an agency's (nominal) supervision. (Ironically, turf in this case grew through dong as little regulation as possible.) At the individual level, the "revolving door" between private sector finance and the regulatory agencies introduced powerful conflicts of interest that arguably dampened regulators' zealousness in pursuing effective regulatory policies and enforcement actions. Finally, as the influence of the financial sector over both the Democratic and Republican parties grew throughout the Clinton and Bush administrations, Congress brought intensifying pressure against regulatory agencies perceived as over-zealous.

This complex confluence of ideas, institutional and individual interests, and political pressures increasing requires a fine-grained analysis of specific policy and regulatory changes to discern the primary mechanism of causation. This is particularly difficult in the case of the SEC, which appears to have been buffeted by conflicting internal and external policy agendas and political imperatives. On the one hand, the SEC's unanimous vote in 2004 to relax leverage rules governing investment banks appears to have been influenced by the neoliberal vision of markets and firms as largely, if not entirely, self-regulating, along with misguided confidence in

the risk management prowess of the largest financial institutions. (Labaton 2008) On the other hand, SEC initiatives to enhance disclosure, strengthen shareholder power and protection in corporate governance, and expand regulatory jurisdiction beyond publicly traded firms and securities issuers to hedge funds and activities within the largely unregulated “shadow” banking system were thwarted by intense pressure from the White House and Congress. Those pressures included hostile congressional hearings and threats to the SEC’s budget and independence.

The external influence of politics was more directly exercised through the appointment of anti-regulation officials to the agency, most importantly Chairman Christopher Cox, who as a congressman from Orange County, California (home to some of the largest and worst mortgage originators) had been the principal author of legislation designed to reduce securities fraud litigation. Under these external and internal political pressures, the SEC’s capacity to pursue even traditional securities regulation, once one of the preeminent post-New Deal regulatory agencies, eroded by neglect and design.[22] Given this erosion of regulatory capacity, the agency’s monitoring of investment banks was grievously understaffed an ineffective just as their volume of business soared and became increasingly reckless and dangerous. The agency that had long regarded itself as the shareholder’s advocate increasingly acted to please political masters allied with the financial sector.

The Ratings Agencies

The marketing and sales of MBSs and CDOs depended on inflated debt ratings, courtesy of rating agencies beholden to the bankers on whom they relied for business. The seemingly miraculous transformation of risky and increasingly reckless mortgage loans into AAA securities was the product of glaring conflicts of interest that induced the adoption o obviously flawed risk models that gave banks the ratings they wanted and demanded. Unregulated and devoid of regulatory oversight, the ratings agencies’ business model of charging fees up front with no residual risk of loss to discourage unduly high ratings was rife with conflicts of interest. The issuer banks’ selection of the ratings agency and payment of its fees short-circuited the self-regulatory function of the NRSROs. Similar to the mortgage lenders’ incentives to increase volume to the detriment of loan quality, the ratings agencies cultivated a volume-driven business in selling ratings increasingly detached from reality. The ratings agencies reaped immense profits from the routinized corruption and debasement of their ratings, apparently with no potential financial downside. They enjoyed a legally privileged market status as part of a private self-regulatory regime for the purpose of protecting investors in debt securities otherwise not protected by federal securities laws. They used their position to maximize profits by selling protection to their investment banking clientele.

The conflicts of interest exploited by the ratings agencies were created and remain unconstrained by government regulation. Even after two vast systemic failures within a decade, the dot.com crash and the global financial crisis of 2007-2009, they have successfully fought off

[22] Under Cox, enforcement actions declined precipitously from 2005 to 2008 as internal authorization and review processes were imposed to discourage investigations of large financial institutions. (Scannell and Craig 2008; Adler 2009; *see generally* GAO 2009) SEC penalties fell 39% in 2006, 48% in 2007, and 49% in 2008 (Farrell 2009). Enforcement attorneys on staff declined over 11 percent over the same period. (Farrell 2009; GAO 2009)

increased regulation. In part, the federal courts have aided and abetted the ratings agencies' rearguard anti-regulation defenses. In another perverse twist of First Amendment free speech doctrine to rival the *Citizens United* decision, federal courts have repeatedly held that the NSRO's ratings are protected as opinion rather than subject to fraud actions for misstatements of material facts in commercial securities transactions. This doctrine is currently being challenged, but has not been overturned (yet) by any federal Court of Appeal, let alone the U.S. Supreme Court. However, the courts are not solely to blame for the regulatory vacuum that has allowed the ratings agencies to wreak so much damage while pursuing their narrow self-interests.

Despite repeated rounds of congressional hearings documenting the NSROs record of opportunism and shoddy work, Congress and financial regulators have failed enact or adopt meaningful regulatory reforms that would address the ratings agencies' obvious and recurrently destructive conflicts of interest. Implicated in the dot.com and Enron era accounting scandals, the ratings agencies emerged from the Sarbanes-Oxley reforms untouched. Following their far more egregious conduct during the housing and debt securitization bubble, to date, they *still* have escaped unscathed. As entities central to the operation—and recurrent manipulation—of the debt securities markets, they are powerful corporations in their own right and, perhaps more importantly, they have extremely powerful allies in the too-big-to-fail financial institutions at the pinnacle of the financial sector with immense resources to lobby against policies and reforms that would disturb the status quo.

Credit Default Swaps

Credit default swaps, particularly those issued by AIG, played a critical role in facilitating and prolonging the real estate and securitization bubble, and in making the inevitable financial crash vastly worse. These derivatives allowed banks and other financial institutions to produce and hold more MBSs and CDOs by allowing them to claim that any risks were hedged. Under normal circumstances, this might have been the case, and it appears that many financial institutions believed they had hedged their risks by buying CDS protection against losses on debt securities. But nothing was normal any longer. The massive scale of speculation enabled by the issuing of CDSs not for hedging risk but for placing speculative bets on mortgage and securities defaults magnified systemic risk and eventual losses once the crash came. In general, speculation of this sort, even on this scale, is a formalization of conflicting interests, not a conflict of interest. However, CDSs played a critical role in several different systemic conflicts of interest that would unleash devastating consequences.

First, AIG's issuing of hundreds of billions of dollars worth of CDSs and its retention of many of them on its own books created a conflict in that the company would never be able to pay off on the liabilities it had created. AIG's interests in short-term profits conflicted with its purchaser-counterparties' interests in receiving promised payments in the event the covered MBSs and CDOs defaulted. AIG, the world's largest insurance company could never have taken on so much risk and left its counterparties completely unprotected in its traditional insurance business; it would have violated innumerable insurance regulations. The company took advantage of the completely unregulated status of the derivatives business and markets to pursue such a reckless strategy. When the financial crisis struck and AIG could not pay it counterparties the compensation they were entitled to, those parties were left with very real losses they had not

anticipated and that threatened many of them with collapse.

Second, as the real estate bubble neared its peak, investment banks and hedge funds developed strategies using CDSs to prolong the bubble and to extract a final run of immense profits from investors. The deceptiveness of this increasingly baroque securitization business reached its nadir in the marketing of securities comprised of the worst quality, highest risk mortgages available that were designed to fail in order to generate profits from CDSs, undisclosed to the buyers, that would pay off when the securities defaulted. Because they relied on the riskiest mortgages, these securities and transactions kept the securitization cycle flowing even as the quality of mortgages plummeted, thereby enabling the creation of even more toxic securities.[23]

The regulatory vacuum that allowed CDSs to become so systemically destructive was the result of one of the most serious policy and regulatory failures in history, and one that exemplifies the politics of finance capitalism that has taken hold since the 1980s. The Commodity Futures Modernization Act of 2000 preemptively deregulated derivatives, including CDSs—and with solid Democratic support in the Clinton White House and Congress. During the Clinton administration, Federal Reserve Chairman Allen Greenspan, Treasury Secretary Robert Rubin, and Assistant Treasury Secretary Lawrence Summers thwarted an attempt to regulate derivatives by Commodities Futures Trading Commission Chair Brooksley Born. (Faiola et al. 2008) They disputed warnings that leaving derivatives unregulated posed enormous potential systemic risks and countered that the rational self- interest of sophisticated parties and the efficient operation of financial markets would provide adequate self- regulation, while regulation would hamper beneficial financial innovations. (Faiola et al 2008; see, e.g., Greenspan 2002) Under intense pressure from the White House and the financial sector's powerful allies in Congress, the SEC also supported the suppression of derivatives regulation. The Commodity Futures Modernization Act enshrined this attack on derivatives regulation in legislation. Drafted by Phil Gramm, the Republican chairman of the Senate Banking Committee, the law elicited no significant dissent from the Clinton administration or congressional Democrats and passed overwhelmingly. The law is historic not only in its extraordinary, perhaps uniquely, sweeping preemptive character, or due to the vast economic damage it enabled, but also as the moment at which the Democratic alliance with Wall Street became clear and open. Preemptive derivatives deregulation and laissez faire finance became a thoroughly bi-partisan agenda. Aside from its subject matter, this legislation exemplifies the trajectory of policy, regulation, and partisan politics driven by the increasing wealth and power of the financial sector.

C. The Failure of Regulation and the Failures of Reform

All the foregoing policy and regulatory failures point to a more fundamental, and even more disturbing, conflict of interest at the core of contemporary finance capitalism. That conflict of interest pits the self-interest of politicians and parties in alliance with the financial sector,

[23] Over time, fewer people could truly afford homes at bubble inflated prices, jeopardizing the continuous flow of mortgages and rising prices necessary to maintain the expansion of the real estate bubble and the securitization cycle. The story of these duplicitous deals has been told in many books, articles, congressional hearings, and court papers.

against the public good and general welfare. It is one that afflicts both major parties and many elected officials. Regulation could have curtailed or broken the securitization cycle by at any given point in the process and at any moment during the inflation of one of the largest speculative bubbles (if not the largest) in history. Had that occurred, through any available regulatory mechanism, the intervention would have halted the necessary circular flow of funds and the inflation of the real estate and securitization bubbles would have ceased. At every point in the securitization cycle, for years on end, regulation and politics failed, and they failed for systemic reasons that show no signs of dissipating.

Riddled and in substantial part defined by mutually self-reinforcing conflicts of interest, neo-liberal finance capitalism has developed into an inversion of the liberal market ideal, blurring and fusing public and private power that poses a growing threat to economic stability and broad-based prosperity, democratic governance, and political legitimacy. (*See generally* Johnson and Kwak 2010; Smith 2010; cf. Skeel, 2011). Immediately following the global financial crisis, there was a widespread expectation that financial sector and markets, in the U.S. and abroad, would be subject to rapid and far-reaching reforms that would redress the most pathogenic and dangerous features of neo-liberal finance capitalism. More than a decade after the beginning of the financial crisis in the U.S., it is far from clear that the American political system (or that of the European Union) is remotely capable of fashioning, let alone implementing, such fundamental structural and regulatory reforms.[24] By the time Congress finally passed a financial reform bill, the Dodd–Frank Act, in July 2010, the most important reform proposals were purged or enfeebled during the legislative process, including:

- The break up of too- big-to-fail banks,
- Intensive regulation and oversight of the NSRO ratings agencies,
- Effective transparency and prudential regulation of the “shadow” banking system,
- A ban (or substantial restrictions) on proprietary trading by banks,
- Derivatives regulation and the creation of mandatory public exchanges for derivatives transactions,
- Effective regulatory oversight and control of systemic risk,
- More stringent regulation of financial institutions’ leverage ratios and capital requirements, and
- Creation of resolution authority to process the bankruptcies of large “systemically sensitive” financial institutions.

Consolidation and rationalization of federal regulatory authority was jettisoned in favor of strengthening the role of the Federal Reserve within a still fragmented regulatory structure susceptible to gaming by financial institutions. Greater reliance on the regulatory functions of

[24] In Europe, the crisis of the shadow banking system triggered the ongoing and seemingly intractable Eurozone crisis. This crisis is distinct from and causes and logic of the earlier American financial crisis, but a disturbing and dysfunctional relationship between public and private power, finance and the state, parallels the development and contradictions of American finance capitalism. The Eurozone crisis is commonly described as a sovereign debt crisis of the “peripheral” EU member states but was really a banking crisis in the core countries of the EU (and may still be—the reliability of data regarding the banks’ balance sheets remains dubious) in which governments have bailed out and buttressed their banking systems by shifting implicitly, if not explicitly, the bad debts of large private banks onto the state. This banking crisis underlies the ongoing sovereign debt crisis that threatens the future of the euro and the EU itself—and has made it virtually impossible to resolve.

the Fed gave more responsibility to the very institution that had explicitly refused to exercise its existing powers for ideological reasons and had spearheaded the structural changes that created the foundations for neo-liberal, laissez faire finance capitalism. If the allocation of power and authority was reinforced by post-crisis politics, so too was the power and position of the financial sector and the largest financial institutions. The measures taken to stave off economic disaster have strengthened financial interests and institutions within the U.S. political economy.[25]

The power dynamics generated by interlinked conflicts of interest help to understand how these paradoxical outcomes emerged. The political economy of finance capitalism has generated feedback loops that channel ever more wealth and power to those who control the largest financial institutions. Underlying these feedback dynamics institutionalized conflicts of interest endow financial interests with economic and political advantages that are self-reinforcing. Both these conflicts of interest and the feedback effects they have fostered are now deeply and increasingly entrenched. Given the minimal and ineffectual reforms that followed the worst economic crisis in nearly a century, it appears that even the self-destructiveness of the resulting political economic order has left neoliberal finance capitalism intact—if not unscarred and entirely unchanged. However, studying the structural architecture of this political economic order and its pathologies is a necessary step towards understanding it and directing political energies and capital at those features identified as the most dysfunctional, dangerous, and destructive.

[25] Managerial power within corporate firms, which contributed to the governance failures within financial institutions, also survived an unprecedented legislative and regulatory threat. The SEC had adopted regulations mandating more competitive corporate board elections in order to give shareholders greater influence over firm governance, and these rules that were explicitly enabled by the Dodd-Frank Act. The Court of Appeals for the D.C. Circuit struck down these rules on the specious grounds that the SEC's cost-benefit analysis was deficient. (See *Business Roundtable v. S.E.C.*, 647 F.3d 1144, 1146 (D.C. Cir. 2011), vacating Rule 14a-11, 17 C.F.R. § 240.14a-11 (2010)). Whether the court's invocation of cost-benefit analysis was consistent with applicable law is questionable at best, as is the specifics of its analysis. (See, e.g., Hayden and Bodie, 2012) The decision is far more comprehensible as an ideological act than as a principled legal ruling. Like the Supreme Court's steady gutting of campaign finance law (or, more obviously, it's decision in *Bush v. Gore*), this raises the issue of judges and courts as implicated in conflicts of interest that reflect partisan political bias, not merely ideological values and policy preferences.

Figure 1: The Mortgage Securitization Cycle—Securitization and Distribution of Subprime Mortgage-Backed Securities

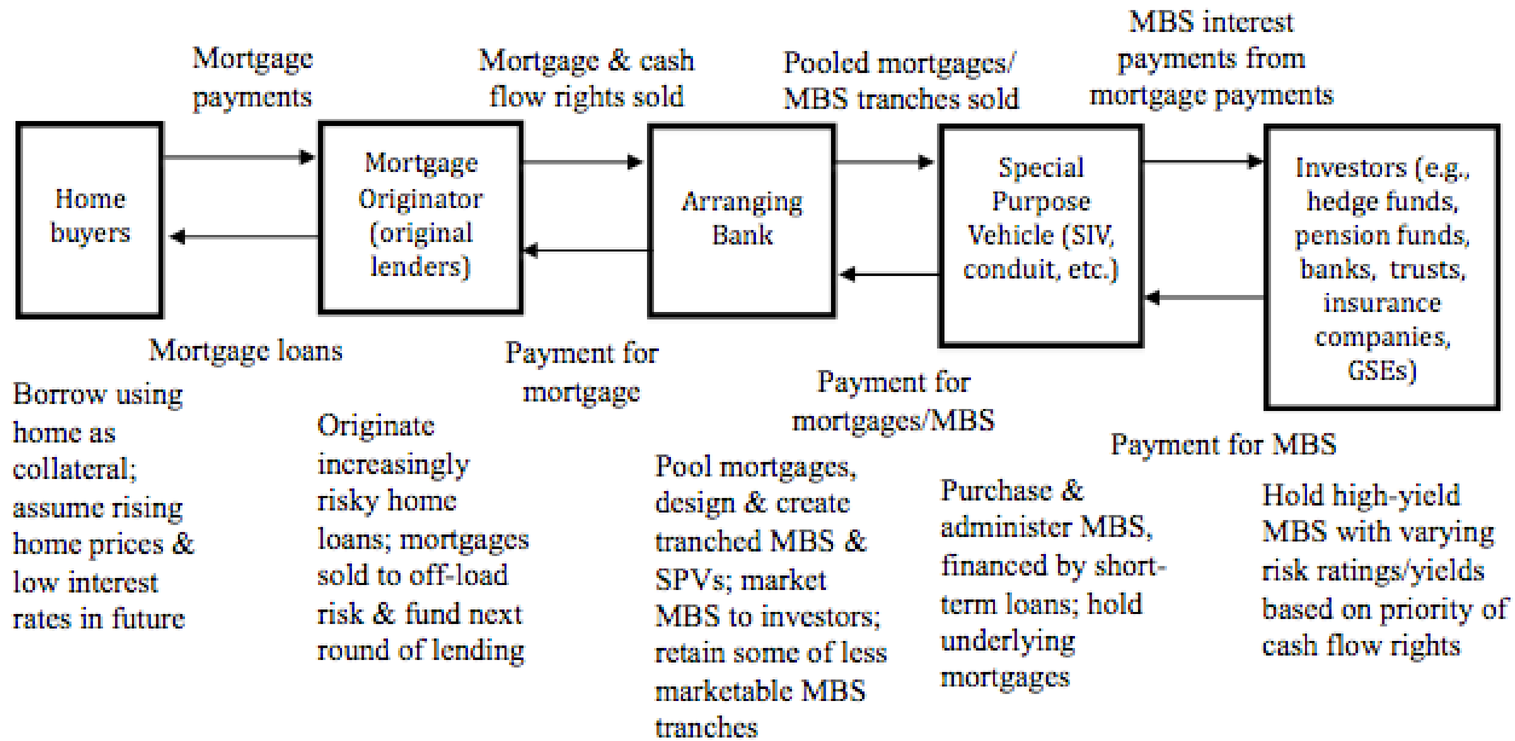
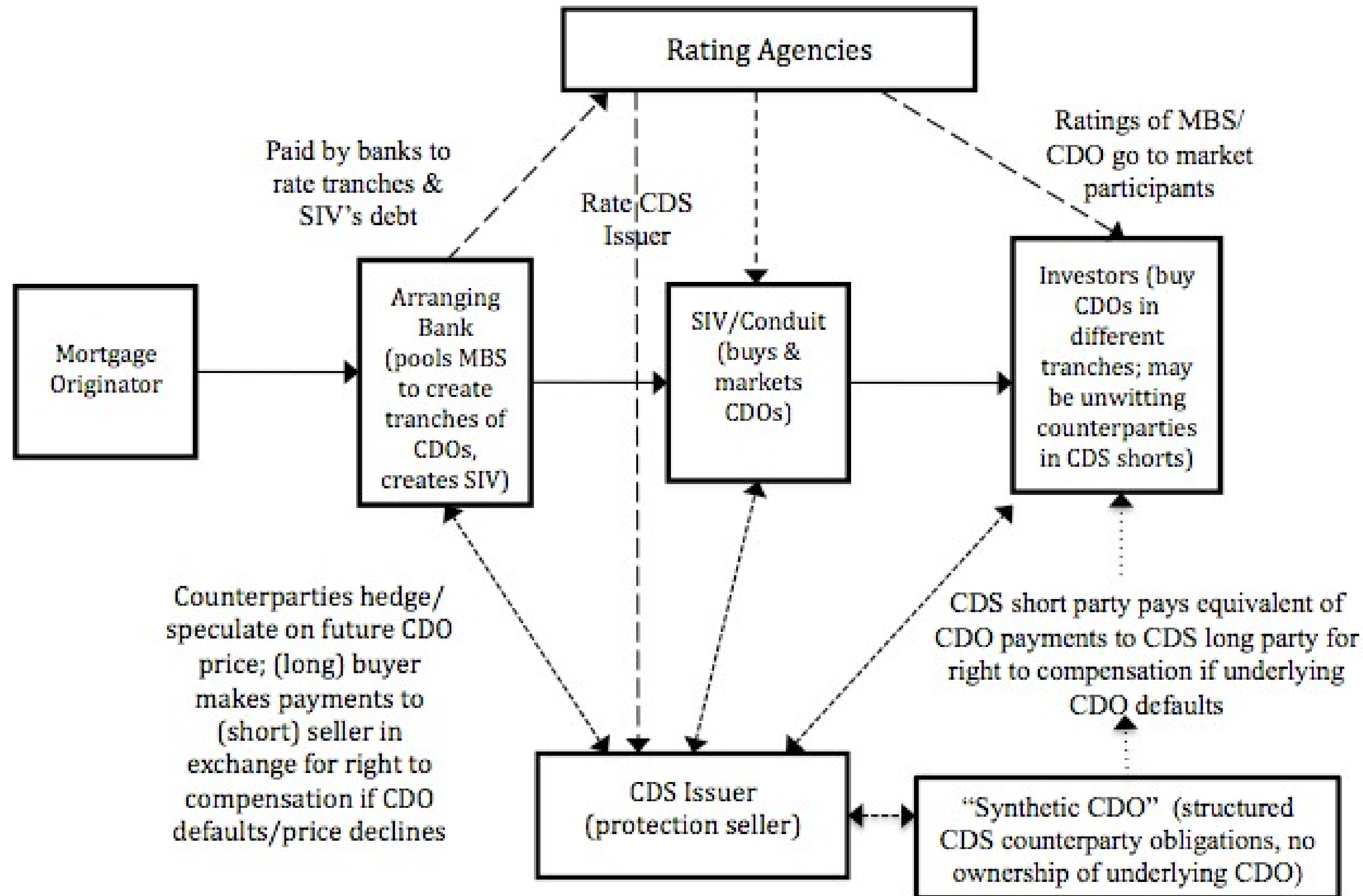


Figure 2: The CDO and CDS Securitization Web—Main Participants and Relationships



References

Adler, Joe (2009), 'In reports on failures, regulators also fail', *American Banker*, 15 April.

Campbell, John L. (2004), *Institutional Change and Globalization*. Princeton, NJ: Princeton University Press.

Cioffi, John W. (2010), *Public Law and Private Power: Corporate Governance Reform in the Age of Finance Capitalism*. Ithaca, NY: Cornell University Press.

(2011), "After the Fall: Regulatory Lessons from the Global Financial Crisis," in David Levi-Faur, ed., *Handbook of Regulation*, pp. 642-661 (Edward Elgar, 2011)

Erhard Friedberg (2012), "Conflict of Interest for the Perspective of the Sociology of Organized Action," in Anne Peters and Lukas Handschin, *Conflict of Interest in Global, Public and Corporate Governance*. Cambridge and New York: Cambridge University Press.

Faiola, Anthony, Ellen Nakashima, and Jill Drew (2008), 'What Went Wrong', *Washington Post*, 15 October.

Farrell, Greg (2009), 'Cox regime at SEC under Fire', *Financial Times*, 7 May.

GAO (United States Government Accountability Office) (2009), "'Securities and Exchange Commission: greater attention needed to enhance communication and utilization of resources in the division of enforcement', report to congressional requesters." GAO-09-358, March.

Greenspan, Alan (2002), "Remarks by Chairman Alan Greenspan Before the Society of Business Economists, London, U.K." The Federal Reserve Board, 25 September, available on line at http://www.federalreserve.gov/BoardDocs/Speeches/2002/200209252/default.htm.

Hacker, Jacob and Paul Pierson (2010), *Winner-Take-All Politics: How Washington Made the Rich Richer—and Turned Its Back on the Middle Class*. New York: Simon & Schuster.

Hall, Peter A. and David Soskice (2001), "Introduction to Varieties of Capitalism," in Peter A. Hall and David Soskice, *Varieties of Capitalism*. Oxford University Press, pp.1-68.

Hayden, Grant M. and Matthew T. Bodie (2012), "The Bizarre Law & Economics of *Business Roundtable v. SEC*," *Journal of Corporation Law*, vol. 38, no. 1, p. 101, available on line at http://ssrn.com/abstract=2115495.

Hudson, Michael W. (2010), *The Monster: How a Gang of Predatory Lenders and Wall Street Bankers Fleeced America and Spawned a Global Crisis*. New York: Times Books/Henry Holt & Co.

Johnson, Simon and James Kwak (2010), *13 Bankers: The Wall Street Takeover and the Next Financial Meltdown*. New York: Random House.

Levy, Jonah D., "The State Also Rises: The Roots of Contemporary State Activism," in Jonah D. Levy, ed., *The State After Statism: New State Activites in the Age of Liberalization*. Harvard University Press, pp. 1-28.

McCann, Michael and William Haltom (2004), *Distorting the Law: Politics, Media, and the Litigation Crises*. Chicago: University of Chicago Press.

National Conference of State Legislatures (2013), Conflict of Interest Definitions, updated April, available on line at http://www.ncsl.org/legislatures-elections/ethicshome/50-state-table-conflict-of-interest-definitions.aspx.

OECD (2003), Recommendation of the Council on Guidelines for Managing Conflict of Interest in the Public Service, p. 4, June, available on line at http://www.oecd.org/dataoecd/13/22/2957360.pdf.

OECD (2005), Managing Conflict of Interest in the Public Sector—A Toolkit, p. 13, Paris: OECD, available on line at http://www.oecd.org/gov/ethics/49107986.pdf.

Peters, Anne and Lukas Handschin, *Conflict of Interest in Global, Public and Corporate Governance*. Cambridge and New York: Cambridge University Press.

Pierson, Paul (1993), "Review: When Effect Becomes Cause: Policy Feedback and Political Change," *World Politics*, 45 (4), pp. 595-628.

(2004). "Limits of Institutional Design," in *Politics in Time: History, Institutions, and Social Analysis.* Princeton University Press, pp. 103-132.

Saint-Martin, Denis (2008), "The Watergate Effect: Or, Why Is the Ethics Bar Always Rising?" in Trost, Christine and Alison L. Gash, eds. (2008), *Conflict of Interest and Public Life: Cross-National Perspectives* (New York and Cambridge: Cambridge University Press).

Scannell, Kara and Susanne Craig (2008), 'SEC chief under Fire as Fed seeks bigger Wall Street role', *Wall Street Journal*, 23 June.

Schattschneider, E. E. (1935), *Politics, Pressures, and the Tariff* (New York: Prentice Hall).

Skeel, David (2011), *The New Financial Deal: Understanding the Dodd-Frank Act and It's (Unintended) Consequences*. Hoboken, NJ: John Wiley & Sons.

Smith, Yves (2010), *ECONned: How Unenlightened Self Interest Undermined Democracy and Corrupted Capitalism*, New York: Palgrave Macmillan.

Streeck, Wolfgang (2010), "E Pluribus Unum? Varieties and Commonalities of Capitalism," MPIfG Discussion Paper 10 /12, Max Planck Institute for the Study of Societies, Cologne, October.

Streeck, Wolfgang and Kathleen Thelen (2005), “Introduction: Institutional Change in Advanced Political Economies,” in Wolfgang Streeck and Kathleen Thelen, eds., *Beyond Continuity: Institutional Change in Advanced Political Economies*. Oxford University Press, pp. 1-39.

Tett, Gillian (2009), Fool’s Gold: How the Bold Dream of a Small Tribe at J.P. Morgan Was Corrupted by Wall Street Greed and Unleashed a Catastrophe, New York: Simon & Schuster.

Trost, Christine and Alison L. Gash, eds. (2008), *Conflict of Interest and Public Life: Cross-National Perspectives* (New York and Cambridge: Cambridge University Press).

United States Supreme Court, *Citizens United v. Federal Election Commission*, 130 S.Ct. 876, 908 (2010)

Jacobellis v. Ohio, 378 U.S. 184 (1964) (Stewart, J., concurring).