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### Theology of the "Real Economy": Christian Economic Ethics in an Age of Financialization

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## INTRODUCTION

“Financialization” is a term bantered about by economists and financial analysts for the past couple of decades to describe the process by which economic activity shifts from “real” production of goods and services to ever more complex forms of financial transacting. Various interpretations of this phenomenon have been offered from Nobel laureate James Tobin’s observation of the “casino aspect of our financial markets” to the definition Greta Krippner applies: a “pattern of accumulation in which profit making occurs increasingly through financial channels rather than through trade and commodity production.”<sup>1</sup> Thomas Palley says it is the process by which financial institutions, markets, and elites “gain greater influence over economic policy and economic outcomes.”<sup>2</sup>

Yet some are leery in even approaching the subject for the implication that there should be some appropriate level of financial control vis-à-vis other activity in capitalist economies determined beyond markets. Talk of disallowing or taxing disproportionately certain types of investments, restricting the compensation of financial managers, or taking political action to break up the financial industry implies social constructivism of the kind Friedrich Hayek warned against. What is for some the manipulation of financial markets by elites is, for others, a natural development in capitalist economies that leverages technology, human creativity, and the acquisitive nature of the individual in a global culture where profitability is considered necessary to survival.<sup>3</sup> If recent innovations and the explosion of financial activity are natural developments, then attempts to regulate their outcomes may well have unintended and undesirable consequences. Indeed, the enormity and controversial nature of the Dodd-Frank Bill passed in July 2010 suggests that we may be embarking on a tit-for-tat game between regulatory agencies and banking and investment firms that has the potential to worsen

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<sup>1</sup> James Tobin, “On the Efficiency of the Financial System,” *Lloyds Bank Review*, 1-2, 15 (July 1984). Greta Krippner, “What is Financialization?” mimeo; Department of Sociology, UCLA; cited in Gerald A. Epstein, *Financialization and the World Economy* (Northampton, MA: Edward Elgar Publishing, 2005), 3.

<sup>2</sup> Thomas I. Palley, “Financialization: What It Is and Why it Matters,” Levy Economics Institute, Working Paper no. 525 (December 2007): 2; accessed at <http://www.levy.org> on 22 March 2011. John Bellamy Foster provides a brief etymology of this term financialization in “The Financialization of Capitalism,” *Monthly Review* 58 (April 2007); accessed at <http://www.monthlyreview.org/0407jbf.htm> on 21 March 2011. See also Özgür Orhangazi, *Financialization and the US Economy* (Cheltenham, UK: Edward Elgar Publishing Limited, 2008).

<sup>3</sup> Robert E. Litan, senior fellow at the Brookings Institution, authored a paper defending changes in the finance industry over the past several decades and, while acknowledging “a mix between good and bad financial innovations,” he says, “on balance I find more good ones than bad ones.” See “In Defense of Much, But Not All, Financial Innovation,” *Brookings* (February 17, 2010); accessed at [http://www.brookings.edu/papers/2010/0217\\_financial\\_innovation\\_litan.aspx](http://www.brookings.edu/papers/2010/0217_financial_innovation_litan.aspx) on 30 June 2011.

bureaucratic inefficiency, concentrate market power, and perhaps even further destabilize the financial system.<sup>4</sup>

Despite the good of financial innovations over the past century, recent developments are troubling and the weight of both popular and scholarly opinion suggests something has gone wrong in the global financial system. Although not using the exact term, religious critics of practices that led to the crisis admonish behaviors similar to those associated with financialization. In his 2009 encyclical *Caritas in Veritate* (*Charity in Truth*), Pope Benedict echoes the criticism of many religious observers by describing the “damaging effects on the real economy of badly managed and largely speculative financial dealing.”<sup>5</sup> Such comments by religious leaders are common yet they imply incompletely articulated ideals of what constitutes real economic growth. Christian critics are often unclear in showing how, in an age of ever-increasing financial specialization and sophistication, it is possible to distinguish real production from what they perceive as financial sophistry and how religious values, practices, or institutions might aid this effort. How are we to determine those financial activities that siphon resources from more socially beneficial uses? At what point does financial innovation cease to benefit the general economy and turn purely self-interested? Are there moral guidelines within Christianity capable of establishing tangible and reliable boundaries for investment and curbing the trend of financialization? This essay addresses these questions by briefly reflecting on the crisis, surveying both secular and Christian responses to it, and proposing ecumenical engagement in “theology of the real economy” to substantiate religious criticism of financialization, help guide the growing sector of faith-based investment, and contribute to a more ethical foundation for the global economy.

One of the primary criticisms of financialization is that it has “legitimized the adoption of strict monetary calculation over the many immaterial and social issues implied in economic choices.”<sup>6</sup> Some of those social issues are inevitably religious or influenced by religious institutions and practices. This essay observes some of the negative consequences of financialization – arbitrariness in wealth creation, rising financial instability, growth in moral hazard – and contends that reliance on government regulation to resolve these issues will not succeed because of the embeddedness of regulatory agencies in the political system<sup>7</sup> and

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<sup>4</sup> Arthur D. Postal, “Industry, Legislators, and Administration Clash over Dodd-Frank Implementation,” *National Underwriter: Property and Casualty* (April 25, 2011); 115, 15; ProQuest pg. 24.

<sup>5</sup> Benedict XVI, *Caritas in Veritate*, 2009, no. 21.

<sup>6</sup> GianDemetrio Matrangoni and Stefano Solari, “The ‘Good Company’ and Financialization: Corporate Choices, Institutional Environment, and Catholic Social Thought”; paper presented at the Sixth International Symposium on Catholic Social Thought and Management Education, Pontifical University of St. Thomas, Rome, Italy (October 5-7, 2006); accessed at <http://www.stthomas.edu/cathstudies/cst/conferences/thegoodcompany/Finalpapers/marangoni-solariUST.pdf> on 6 June 2011.

<sup>7</sup> Richard Freeman, “It’s financialization!” *International Labour Review* 149, no. 2 (2010): 178.

their inability to control (or even to discern) participants' incentives in the complexity of financial markets. Developing an ethical basis for investment requires broad institutional support. Another lesson being learned in the crisis is that "it takes a village" to balance elements of the global economy in achieving morally and materially sustainable growth. Christianity, as the largest religious tradition of the Western world, has millions of investor adherents with enormous potential to shape the nature of finance and investment.

The severity of present problems suggests that resolution must be bottom-up not top-down, involving transformation of the financial culture. Broad ecumenical participation in theological development offering religious perspectives on what comprises real economic growth could enable avenues for value expression through investment in an age when investors are increasingly uncertain of what they own and whether their holdings are consistent with their beliefs. It can also help overcome D. Stephen Long's observation that "theological language is primarily protest – against the market and the church, often in the name of social facts that do not seem to have been given a theological reading."<sup>8</sup> Establishing theological parameters for real production can contribute to the achievement of justice in the global economy and perhaps even reduce the need for state regulation that many have called for but few desire.

#### EVIDENCE OF FINANCIALIZATION

The global financial crisis was caused by a confluence of forces. Freshly deregulated banks and investment firms began testing traditional boundaries in attempts to maximize profits, implicitly constructing new standards for risk and return. Consumers pressed a similar envelope on what is "affordable housing," engaging innovative forms of mortgage financing that leveraged families as never before. Corporations in non-financial sectors saw greener pastures in possibilities for large returns from the investment side of their organizations, often neglecting traditional lines of business. A system of enormous complexity grew beyond the abilities of regulators to control (or even adequately observe) its extreme tendencies.

In many ways the crisis resulted from natural responses to market conditions by participants who believed they were following the rules of the game they were presented to their logical conclusion. Moreover, that aspect of the financial system seems not to have changed much. Wall Street traders and analysts likely engage in many of the same practices today that they performed before 2008. Simon Johnson, a professor at MIT and former chief economist for the International Monetary Fund, believes that incentives are still "distorted" such

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<sup>8</sup> D. Stephen Long, *Divine Economy: Theology and the Market* (New York: Routledge, 2000), 262.

that if banks were to “turn themselves into well-behaved, responsible entities that never cause another financial crisis, economics will have failed.”<sup>9</sup> Johnson suggests that incentives for risky behavior are greater today because the “reform” policies undertaken have transformed companies that once perceived themselves as too big to fail into institutions that are “definitely too big to fail.”<sup>10</sup> Already there is talk of “reform fatigue” after passage in the U.S. of the Financial Reform Bill and complementary Basel III Accord in Europe.<sup>11</sup> Compensation for bankers, financial services managers, and others that have been pilloried in the crisis has changed little.<sup>12</sup> The EU’s internal market commissioner, Michael Barnier, stated regarding bank bonuses in 2011: “I think a certain number of bankers haven’t understood. It’s restarting like before. The calls for moderation haven’t been heard.”<sup>13</sup>

Palley sees the increasing debt load in the U.S. as defining of financialization, noting how credit market debt grew from 140 to 328.6 percent of GDP from 1973 to 2005.<sup>14</sup> Other evidence of this phenomenon include alterations in the functional distribution of income, stagnation of wages, and rising income inequality resulting from action by “financial sector interests.”<sup>15</sup> Income changes arising from financialization occur because of the increasing detachment of financial transactions from the real production of goods and services; according to Charles Leadbeater, “economies have become overlaid with a heavy financial superstructure bearing little relation to underlying activity.”<sup>16</sup> The transition from national, industrial economies to global information- and service-based economies over the past century, however, makes it unsurprising that finance has risen in importance. Technology has facilitated greater volume of financial transactions and greater complexity of those transactions. The question to be answered is *what should be* the magnitude of financial versus other economic activity in contributing to some conceptual entity we can describe as the real economy.

In terms of raw numbers, there is evidence to support the idea that the financial economy may be growing beyond its proportionate contribution to

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<sup>9</sup> Simon Johnson, “Financial Oligarchy and the Crisis,” [interview with Harvey Stephenson] *The Brown Journal of World Affairs* 16 (Spring/Summer 2010): 167.

<sup>10</sup> *Ibid.*, 159.

<sup>11</sup> Nikki Tait, “Barnier warns of complacency as reform fatigue starts to loom,” *Financial Times* (2011, March 20); accessed June 6, 2011 at <http://www.ft.com/intl/cms/s/0/22c6a6a4-5314-11e0-86e6-00144feab49a.html#axzz1RoaxHEcQ>.

<sup>12</sup> Lauren Willington, & Vivek Ahuja, “Bank Pay Rose Almost 10% in 2009,” *Wall Street Journal (Online)* (2010, March 3); retrieved from ABI/INFORM Global (Document ID: 1975224401) on 21 March 2011.

<sup>13</sup> Tait.

<sup>14</sup> Palley, 6.

<sup>15</sup> *Ibid.*, 14.

<sup>16</sup> Charles Leadbeater, “The Right Kind of Innovation,” *Financial World* (February 2011): 12.

economic output. One observes sizable increases in the financial sectors of major economies in recent years. The value of world financial assets grew from \$12 trillion in 1980 to \$140 trillion by 2005; the latter figure is over three times the value of the world's output of goods and services in that year.<sup>17</sup> The International Labour Organization's study of national income reported that profits in the financial sectors of 17 countries rose from 32 percent in 1990 to more than 40 percent by 2005, and that the ratio of wages and salaries in the financial sector vis-à-vis all workers in the private economy rose from 25 to 38 percent in the same period.<sup>18</sup> From its inception in the 1980s until 2009, for example, trading in interest rate derivatives exploded to around \$390 trillion.<sup>19</sup> Similarly, trading on foreign exchange markets was at around 11 times the total value of global trade in 1980; that figure expanded to 73 times the value of global trade by 2009.<sup>20</sup> Freeman notes that the ratio of financial assets to GDP rose dramatically from 10-15 percent in the three decades following World War II to 35-40 percent in the 1980s and 1990s.<sup>21</sup> But those numbers don't provide a full picture. Has the productivity of the financial sector in its contribution to total economic output justified the observed reallocation of resources in favor of finance?

In assessing the long-term productivity of finance, the Director of Financial Stability at the Bank of England, Andrew Haldane, notes that in the United Kingdom returns to intermediation were stable for the period between 1948 and 1978, averaging approximately 1.5 percent of profits in the overall economy. That ratio, however, explodes to around 15 percent of total profit in the economy by 2008.<sup>22</sup> The United States shows similar increases in growth measurements of the financial sector. The gross value added (GVA) of the U.S. financial industry as a proportion of total economy GVA rose from around 2 percent of gross domestic product (GDP) in 1950 to approximately 8 percent contemporarily. Global bank profits contribute additional evidence, expanding at an annual rate averaging almost 15 percent between 2000/01 and 2007/08.<sup>23</sup>

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<sup>17</sup> Orhangazi, 11.

<sup>18</sup> International Institute for Labour Studies, *World of Work Report 2009: The Global Jobs Crisis and Beyond*, 2009; cited in Freeman, 167.

<sup>19</sup> Leadbeater, 12. Interest rate derivatives are the most common of all derivatives and involve a contract between parties the underlying asset to which is the right to receive or pay a given sum at a specified rate of interest.

<sup>20</sup> Ibid., 12.

<sup>21</sup> Freeman, 167.

<sup>22</sup> Andrew Haldane, "The Contribution of the Financial Sector: Miracle or Mirage?"; paper presented at the Future of Finance Conference, London (14 July 2010), 4. The paper later appeared as part of a chapter co-authored by Andrew Haldane, Simon Brennan, and Vasileios Madouros in *The Future of Finance: The LSE Report* (London: London School of Economics and Political Science, 2010).

<sup>23</sup> Ibid., 4-5.

These increases presumably are not problematic if finance is playing an increasingly important role in overall economic production – if *gross value added* is indeed an accurate measure and in line with the financial sector's overall growth. What gives rise to concern according to Haldane in determining the contribution of the financial sector is the ability of the system to price risk correctly. Pavlov and Wachter show how systemic risk in the present crisis has been caused by asset price inflation as lenders underprice credit in order to boost their market share.<sup>24</sup> Freeman notes that until the recent crisis, the work of “mathematical finance quants” was presumed good in creating innovative financial models and associated products that spread risk broadly among those with greater risk tolerance and worked in combination with investment managers “who sought to deploy capital more productively.”<sup>25</sup> The innovative aspects of these models are now being questioned. Moreover, the inability of consumers to directly observe financial risk in combination with inherent complexity in its determination, the concentration of firms that perform this function, and wild optimism in assessments of economic growth have led to consistent underpricing of risk for years. Haldane draws an analogy to the automobile market and the consequences of “second-hand car dealers consistently selling lemons.” Such unscrupulous (or perhaps, giving them benefit of the doubt, incompetent) dealers will be found out because “mechanical risk is observable.” By contrast, risk such as that which is associated with financial assets is “unobservable” directly by the consumer (hence the importance of rating agencies) allowing banks and other financial institutions to underprice risk with almost no immediate consequences.<sup>26</sup>

Revelations that growth in systemic risk went unchecked for years and was underpriced industry-wide alters the fundamentals of value-added determinations for the financial industry. Growth measures in finance suggest that something resembling this phenomenon we have labeled financialization has occurred. Reflecting on the crisis in 2010, Greenspan, Mankiw, and Stein observed that yield spreads on CCC and lesser quality bonds and 10-year Treasury notes (the broadest measures of credit risk) fell to what were likely historic lows in spring 2007, with investors' full knowledge that risk had been “underpriced for years.”<sup>27</sup> The underpricing of risk has encouraged speculative behavior across the spectrum from governments to corporations to consumers and

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<sup>24</sup> Andrey D. Pavlov and Susan M. Wachter, “Systemic Risk and Market Institutions,” *Yale Journal on Regulation* (Summer 2009): 445.

<sup>25</sup> Freeman, 176.

<sup>26</sup> Haldane, 9-10.

<sup>27</sup> Alan Greenspan, N., Gregory Mankiw, Jeremy C. Stein, “The Crisis [With Comments and Discussion],” *Brookings Papers on Economic Activity* (Spring 2010): 208.

even to houses of worship.<sup>28</sup> Zaharia, et al, note a spiraling effect in the rise of this risk-friendly system where financial markets have come to “play the role of social security (without any guarantee)”; moreover, the authors believe financialization “has annulled the autonomy of the national political economy.”<sup>29</sup> Palley characterizes one aspect of the “financialization thesis” as the transition to a culture where financial markets not only tolerate corporate debt but “prefer that corporations use debt to finance their activities owing to its tax advantages and higher rates of return on equity that leverage allows.”<sup>30</sup> One might surmise that the entire system now not only encourages but depends on increasing debt levels to lubricate the economic engine.

William Lazonick sees the kind of financialization that has become embedded in corporate decision-making as “the prime source of inequity and instability in U.S. economic performance.”<sup>31</sup> He traces financialization to the movement toward conglomeration by American corporations in the 1960s and rising competitive pressure from Japan in the 1970s. These forces led to the decline of traditional American companies in electronics, steel, machine tools, automobiles, and other industries and eventually forced the transition to a “new economy model” that featured offshoring, information and communication technologies, interfirm labor mobility, and the “intensely speculative and yet highly liquid” stock market NASDAQ, which fundamentally changed the funding of firms and ways in which they handled their earnings.<sup>32</sup>

Lamy notes how many traditional valuation methods of investment banks faltered when applying traditional techniques to new economy firms, leading to over-valuation. Data reveals that the stock price for these firms “follows the macro-economic tendency of the sector more than news or results specific to [the

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<sup>28</sup> The *Wall Street Journal* reported that the mortgage crisis has affected many churches in the United States, in particular, mega-churches that started during the building boom of the 1990s. See Suzanne Sataline, “In Hard Times, Houses of God Turn To Chapter 11 in Book of Bankruptcy --- Strapped Churches Can't Pay the Mortgage After Borrowing Binge; St. Andrew at Auction,” *Wall Street Journal* (Eastern Edition), p. A.1.

<sup>29</sup> Constantin Zaharia, Ioana Zaharia, Nicolae Tudorescu, George C. Zaharia, “The Magnitude of the Global Crisis and its Damaging Effects on the Real Economy,” *Economics, Management, and Financial Markets* 5(3) (2010): 284.

<sup>30</sup> Palley, 20. The late Hyman Minsky speculated in his “financial instability hypothesis” that ebullience in periods of prosperity fuels greater risk-taking and an evolution of credit behavior from hedge to speculative to Ponzi finance. The last stage is one in which debtors become more highly leveraged while realizing they are unable to satisfy current debt obligations; in other words, they take on additional debt knowing that they must either sell assets or take on more debt to make current debt payments. See Hyman P. Minsky, “The Financial Instability Hypothesis,” Working Paper no. 74, May 1992, 7-8; Prepared for *Handbook of Radical Political Economy*, edited by Philip Arestis and Malcolm Sawyer, Edward Elgar. Accessed at <http://www.levyinstitute.org/pubs/wp74.pdf> on 22 March 2011.

<sup>31</sup> William Lazonick, “Innovative Business Models and Varieties of Capitalism: Financialization of the U.S. Corporation,” *Business History Review* 84 (Winter 2010); accessed at <http://www.hbs.edu/bhr/84/4/innovative-business-models.html> on May 20, 2011.

<sup>32</sup> Ibid.



firms themselves].”<sup>33</sup> Excess capacity and overinvestment fueled by deflationary pressures ensued and business capital outlays declined.<sup>34</sup> New economy practices became the norm and led to the rise of a much more speculative American culture where everyone, not just executives and institutional investors but also company employees and individual investors, adopted riskier approaches to investing. Overvaluation was enabled because traditional ratios were ignored and singular factors were overemphasized.

Lazonick’s portrayal of the American economy’s cultural transformation demonstrates the diversity of participants and problems that contributed to the crisis. The standard players are present: irresponsible and overleveraged consumers, greedy investors, short-term oriented executives, and oblivious regulators; in the end, however, a kind of whimsical attitude toward economic growth and the debt levels necessary to sustain it overtook the nation and devalued American ingenuity and industriousness. The old economy eventually soured expectations of a generation that had come to expect extravagant returns given historical norms; the new economy model has fueled growth in intense spurts but, as we are coming to discover, risk is less identifiable and growth is less stable.<sup>35</sup> Incentives across the board fed a perfect storm of financial problems that has affected most everyone in some way.

All these problems would be far less concerning if we could believe with any assurance that they are in our rear view mirror. The fact is that there have been few systemic changes to suggest that participants are better informed of the investment products they sell or purchase, or that regulators now fundamentally understand the markets they regulate.<sup>36</sup> Paul Dembinski sees “ethical alienation” resulting from “the abandonment or loss of criteria other than those of efficiency,” and its contribution to a feeling of helplessness among market participants.<sup>37</sup> Financialization is the culmination of this process that has liberated economics and finance from “metaphysical, societal and political control.”<sup>38</sup> What investors

<sup>33</sup> Marie-Florence Lamy, “Valuation of New Economy Firms,” *Finance India* XVIII (Apr/May 2004): 503.

<sup>34</sup> Charles G. Leathers and J. Patrick Raines, “The Schumpeterian Role of Financial Innovations in the New Economy’s Business Cycle,” *Cambridge Journal of Economics* 28 (September 2004): 673-674. Leathers and Raines note how Alan Greenspan championed Schumpeter’s “perennial gale of creative destruction” as the foundation of robust economic growth in the 1990s without fully understanding the implications of Schumpeter’s thought. Greenspan disregarded Schumpeter’s “second wave” of the cycle where “pure financial speculation arrives and may intensify into a speculative mania,” leading to Federal Reserve passivity in the face of the emerging crisis. See *ibid.*, 669-670.

<sup>35</sup> Lazonick.

<sup>36</sup> Confusion is particularly apparent in attempts at regulatory reform in Europe, where the EU and Great Britain have clashed over the appropriate means to stabilize the financial system. See “Darling Warns EU Financial Regulations Could Be ‘Recipe for Confusion,’” *guardian.co.uk* (2 December 2009 ); accessed at <http://www.guardian.co.uk/business/2009/dec/02/darling-warns-eu-finance-commissioner> on 11 July 2011.

<sup>37</sup> Paul H. Dembinski, “Financial Ethics Trapped by Financialization,” *ethikundgesellschaft* 2 (2009): 14.

<sup>38</sup> *Ibid.*, 15.

seek today as much as anything is meaning and a sense of purpose for economic action.

#### REAL ECONOMIC COSTS OF FINANCIALIZATION

The exact costs of financialization to real economic activity are difficult to quantify, but there is considerable evidence of costs beyond rising debt loads on governments, corporations, and individuals. Hao Li observes how seemingly unrelated commodities like copper, soybeans, and crude oil move in a “synchronized boom-and-bust cycle” because of speculation and, in particular, the aggressive position of institutional investors in commodity futures facilitated via financial firms like Goldman-Sachs.<sup>39</sup> Such movement exaggerates the “natural” business cycle and has the potential to deepen global recessions. The *International Monetary Fund’s World Economic Outlook 2009*, which analyzed data from some 120 recessions and recoveries since 1960, concluded that recoveries from economic slowdowns connected with financial crises require almost three years to reassume the level of output prior to recession and extended an average of 18 months in duration beyond those unassociated with crises.<sup>40</sup> Freeman, citing data from the U.S. Council of Economic Advisers, reported that losses in the present crisis amounted to 8 million American jobs between January 2007 and October 2009.<sup>41</sup> Globally, the International Labour Organization has estimated that employment in advanced countries associated with the recent recession, assuming normal levels of growth, will not recover until 2015.<sup>42</sup>

Loose availability of credit is known to have radically escalated loan defaults in the U.S. vis-à-vis historic norms. Interestingly, the allure of easy money seems even to have changed the nature of default. Changes in the credit culture and its underlying rules have reversed a long-established pattern by American consumers of defaulting on credit card or auto loans before defaulting on their mortgages; consumers today engage in “jingle mail” in a climate where the shame of losing one’s home is vanishing. Homeowners mail their keys to mortgage lenders and walk away, assuming the penalty to their credit scores and seeing it as the least detrimental option available to them. Others engage in another form of “strategic default” by simply continuing to live in their homes without making their mortgage payments – in some cases for years – depending

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<sup>39</sup> Hao Li, “Financialization of Commodities Poses Threat to Real Economy,” *International Business Times* (November 30, 2010); accessed at <http://www.ibtimes.com/articles/87204/20101130/financialization-of-commodities-poses-threat-to-real-economy.htm> on 7 June 2011.

<sup>40</sup> Cited in Freeman, 171.

<sup>41</sup> Council of Economic Advisors. 2010. Economic Report of the President. 2010 Report Spreadsheet Tables, available at <http://www.gpoaccess.gov/eop/tables10html> [accessed 26 May 2010]; cited in *ibid*.

<sup>42</sup> Freeman, 171.

on the political costs of foreclosure to lenders and general bureaucratic confusion to keep them at bay.<sup>43</sup> Some have suggested that the blind spot of rating agencies to the emerging crisis resulted from these changes in credit behavior.<sup>44</sup>

Kedrosky and Stangler have shown evidence of brain drain to financial services from other sectors of the American economy increasingly in need of engineers, scientists, and other professionals to move them forward. Graduate students at the nation's elite colleges and universities turn to finance as a career in greater numbers than they did only a couple of decades ago, which has significant "entrepreneurial consequences" for American culture. They note that by 2006, "the Securities and Commodities Exchanges sub-sector accounted for the twelfth-highest share of science and engineering employment by sub-sector, ahead of semiconductor manufacturing, pharmaceuticals, and telecommunications."<sup>45</sup> The authors also produce data suggesting that financialization may well have limited not only the quantity but the quality of new firm formation in the U.S.<sup>46</sup>

Haldane estimates the total production costs to the global economy resulting from the financial crisis at between 60 and 200 trillion dollars and stated that history suggests these costs will be "persistent" if not "permanent."<sup>47</sup> Regardless of permanence, financial volatility has investors, producers, and consumers reeling from its effects and economic stagnation appears to be with us for the foreseeable future.

### SOCIAL AND ETHICAL COSTS

Beyond the real economic costs are perceived social and ethical effects of financialization that may be just as consequential for long-term stability. O'Boyle, Solari, and Marangoni note three in particular: 1) "progressive separation of economic activities from social norms"; 2) "loosening of moral values in economic decisions"; and 3) "dominance of financial gains over other economic

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<sup>43</sup> Paul Wilson, "CBS Says Not Paying Your Underwater Mortgage 'Best Hope for Some to Stay Afloat,'" *Business and Media Institute*; accessed at [http://www.mrc.org/bmi/articles/2011/CBS\\_Says\\_Not\\_Paying\\_Your\\_Underwater\\_Mortgage\\_Best\\_Hope\\_for\\_Some\\_to\\_Stay\\_Afloat.html](http://www.mrc.org/bmi/articles/2011/CBS_Says_Not_Paying_Your_Underwater_Mortgage_Best_Hope_for_Some_to_Stay_Afloat.html) on 27 June 2011.

<sup>44</sup> Gillian Tett, "Insight: A New Wave of Grime Lurks," *Financial Times* (May 22, 2008) [ft.com]; accessed at <http://www.ft.com/intl/cms/s/0/d17753a-280a-11dd-8f1e-000077b07658.html#axzz1OtarTs28> on 7 June 2011.

<sup>45</sup> Paul Kedrosky and Dane Stangler, "Financialization and Its Entrepreneurial Consequences," Kauffman Foundation Research Series: Firm Formation and Economic Growth (March 2011): 7; accessed at [http://www.kauffman.org/uploadedFiles/financialization\\_report\\_3-23-11.pdf](http://www.kauffman.org/uploadedFiles/financialization_report_3-23-11.pdf) on 7 June 2011.

<sup>46</sup> The authors contend that a smaller financial services sector might create companies of "higher social value" and "cause fewer distortions in capital allocation." *Ibid.*, 14.

<sup>47</sup> Located at <http://shockedinvestor.blogspot.com/2010/03/bank-of-england-financial-crisis-cost.html>.

considerations, such as meeting basic human material needs.”<sup>48</sup> By generating complex institutions and instruments to facilitate capital movement, financialization exacerbates the “economic indirection” that British author and social critic G. K. Chesterton viewed as a morally detrimental aspect of the Industrial Revolution. Chesterton feared that capitalism obscured “causes and consequences” from market participants, making moral action difficult.<sup>49</sup> Similarly, financialization interjects levels of arcane interactions in capital transfer that make it hard to determine the real contributions of individual actors, the real value of assets, and the ethical standards by which the financial system operates.

Reallocation of wealth and rising income inequality commonly are associated with the financialization of capitalism. But it is not only income inequities that are changing social relationships. According to Ronald Dore, financial “disintermediation” is breaking down traditional relationships where banks have facilitated connections between depositors and borrowers, depersonalizing the system of capital provision.<sup>50</sup> That transformation is altering long-term social bonds that have supported the capitalist system for centuries:

Once [borrowers and lenders] depended on trust as much as on collateral, and carried some sense of personal or corporate obligation. Now there are only contractual property relationships which can only be enforced in courts. This is one of the important changes contributing to the general erosion of trust among the members of any society.<sup>51</sup>

Degradation of trust may be worse than Dore believes. Corporate bailouts, renegotiations of mortgage contracts, and various “emergency measures” to resolve financial problems demonstrate that law is no longer the sole standard for enforcement of business obligations. Depersonalized relationships in combination with the willingness of politicians to intervene in contractual arrangements have led to the denigration of law as a standard and to possibilities for opportunistic behavior.

Financialization has helped contribute to creation of a pervasive gambling culture where fiduciary managers follow new conventions in putting the assets under their control at risk in attempting to achieve competitive returns. Ideas of “responsible risk” for state government officials, managers of pension funds, portfolio administrators for religious organizations, stock traders and many others

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<sup>48</sup> Edward J. O’Boyle, Stefano Solari, and GianDemetrio Marangoni, “Financialization: Critical Assessment Based on Catholic Social Teaching,” *International Journal of Social Economics* 37, no. 1 (2010): 7.

<sup>49</sup> See Chesterton’s essay “On Direct Action” [1928], which can be located at <http://distributistleague.blogspot.com/2007/06/on-direct-action.html>.

<sup>50</sup> Ronald Dore, “Financialization of the Global Economy,” *Industrial and Corporate Change* 17, no. 6: 1109.

<sup>51</sup> Ibid.

changed markedly in the 1990s. By 2004 37 states in the U.S., even some traditionally conservative southern states like Georgia, were funding portions of their education systems with substantial revenues derived from lotteries.<sup>52</sup>

Alison Kemper and Roger L. Martin believe that the financial crisis has fundamentally redefined the business-society relationship and calls for a new generation of corporate social responsibility (CSR) theories.<sup>53</sup> They see CSR prior to the crisis as dominated by theories of the firm grounded in the neoclassically influenced Chicago School of Economics and therefore incapable of observing the kinds of “risks and negative externalities” that would have prescribed action to prevent financial mismanagement and misreporting that have contributed to present problems.<sup>54</sup>

Absent understanding of financial processes and the chains of ownership reflected in their maze of monthly statements, investors become increasingly unsure of what they own and who reaps the rewards of their investment activities. Given the dominant role of the market in the U.S. and the rising detachment of individual voters from the political process, it is arguable that the greatest source of value expression in American society today comes via economic transacting. Yet financialization has contributed to confusion in the values expressed through investing. An analogy to this kind of social and moral confusion is to ask how voters would react if, after a national election, it was disclosed that some problem in the voting system had randomly cast votes for candidates across the country. That kind of indeterminacy is being exposed throughout the financial system; investments are often beyond investor comprehension. Socially responsible investing (SRI) and faith-based investing are positive developments in seeking to combat this trend, but they face significant challenges in keeping with the pace of financial innovations. Increasingly, investors are unsure of what they own and uncertain of who is compensated in transaction linkages and at what level and even why. Ethics are atrophied by such a system.

#### CHRISTIAN PERSPECTIVES ON THE FINANCIAL CRISIS

Ethicists and theologians from various Christian traditions have weighed in on the costs of financialization. Bob Goudzwaard, an economist who is a member of the Reformed Christian tradition, is among those who see the dwarfing of the real by the financial economy and society’s pursuit of what he terms a

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<sup>52</sup> Thomas S. Dee, “Lotteries, Litigation, and Education Finance,” *Southern Economic Journal* vol. 70, No. 3 (Jan., 2004): 585.

<sup>53</sup> Alison Kemper and Roger L. Martin, “After the Fall: The Global Financial Crisis as a Test of Corporate Social Responsibility Theories,” *European Management Review* 7 (2010): 229.

<sup>54</sup> *Ibid.*, 235.

“paper god” as uniquely defining of our economic times.<sup>55</sup> Goudzwaard notes how the escalation of “debt money” has fundamentally altered economic relationships. Goudzwaard identifies the real economy as “the part of the economy that involves making, selling, and buying goods and services, from groceries to shoes to doctors’ visits to garbage collection.”<sup>56</sup> By contrast he observes the dramatic growth in money-for-money transactions, citing economist Herman Daly’s estimate that the total amount of money-for-money exchanges now exceeds by some 20 times the total value of transactions in which paper is traded for “real commodities.”<sup>57</sup> This reapportionment of real and money economies over the past few decades has contributed to valuation problems; prices lose their ability to convey worth in an environment where asset complexity leads to misinformation and exchanges are increasingly speculative, creating potential for the corruption of ethics.

St. John’s professor of economics Charles M.A. Clark has offered a “Christian perspective” on the crisis and he sees three principal factors contributing to it: “greed, rising inequality, and the ‘bad’ creation of wealth.”<sup>58</sup> Clark references the theories of John Maynard Keynes and Hyman Minsky on financial instability and the continued development of “money manager capitalism” that has magnified the influence of the money economy over that of the real economy and enabled a situation where “economic activity became separated from the goal of meeting human needs and improving social welfare.”<sup>59</sup> Clark sees the 113.1 percent growth in net worth from 1997 to 2007 – in a time when gross national income grew by only 49.1 percent – as pointing to an unhealthy escalation of monetary valuation over real production.<sup>60</sup> He contends that wealth generation, detached from real production, is at least suspect from the Christian view – when it enhances community and social justice it is good, “but when wealth is created by merely redistributing wealth, incomes or economic rights to the already wealthy, it is bad.”<sup>61</sup>

Pope Benedict XVI is particularly critical of financial speculation “that yields to the temptation of seeking only short-term profit, without regard for the

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<sup>55</sup> Bob Goudzwaard, “A Paper God: How Out-Of-Control Buying and Selling of Money Led to Our Current Crisis,” *Sojourners* (June 2009): 22-26.

<sup>56</sup> *Ibid.*, 23.

<sup>57</sup> *Ibid.*, 24.

<sup>58</sup> Charles M.A. Clark, “A Christian Perspective of the Current Economic Crisis,” *The American Economist* 53 (Spring 2009): 18.

<sup>59</sup> *Ibid.*, 17.

<sup>60</sup> Clark, 23. Clark offers as the source for his table data the *World Bank World Wealth Reports* from various years.

<sup>61</sup> *Ibid.*

long-term sustainability of the enterprise, its benefit to the real economy.”<sup>62</sup> Use of the term “real economy” presumably implies an economic system of tangible goods and services produced by human labor that contributes to a Catholic conception of social good. The pope recognizes that increasing “layers” (institutional, technological, and others) in the financial system not only compromise its stability but also divorce workers from the products of their labor. Benedict suggests the need for “restoration” in finance – a return to a time (perhaps idealized) when the financial system targeted not only material but fully human development – where the entire financial system is “to be aimed at sustaining true development.”<sup>63</sup> Such a transformation requires that “financiers must rediscover the genuinely ethical foundation of their activity, so as not to abuse the sophisticated instruments which can serve to betray the interests of savers.”<sup>64</sup> Both consumers and investors must understand their moral roles to the realization that all purchases and investments involve moral discernment and social responsibility. Financialization sees wealth creation and maximization as the ends of human activity but for the Catholic social tradition, those ends must be balanced with solidarity where “the economy displays solidaristic characteristics because institutions relate the individual to the whole community.”<sup>65</sup> Maragoni and Solari insist that at the rule-level, solidarity aims to assure “a sound institutional environment for economic activities.”<sup>66</sup> Financialization and its esoteric practices, in contrast, have no preference for the soundness of the institutional environment or the solidarity of workers and investors.

Benedict applauds the concepts of “micro-credit” and “micro-financing” for providing an alternative view to the massive structure of global finance, consistent with what he calls “ethical financing” and with insistence on personalism in all forms of commercial transactions.<sup>67</sup> But microcredit has been controversial in recent years with charges of lacking a clear philosophy, excessive dependence on government subsidies, high rates of default, limited numbers of credit recipients, and even fraud.<sup>68</sup> The complexity of the microcredit question and Benedict’s seeming acceptance of it as “good” is evidence that more intense theological reflection on the real purpose of financial intermediation is necessary.

Despite broad criticism of the financial economy by Christians, churches appear conflicted on the issues in many ways, likely due at least in part to the

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<sup>62</sup> Benedict XVI, no. 40.

<sup>63</sup> Benedict XVI, no. 65.

<sup>64</sup> Benedict XVI, no. 65.

<sup>65</sup> Maragoni and Solari, 3.

<sup>66</sup> Ibid.

<sup>67</sup> Benedict XVI, no. 45.

<sup>68</sup> Nitin Bhatt and Shuii Yan-Tang, “Delivering Microfinance in Developing Countries: Controversies and Policy Perspectives,” *Policy Studies Journal* 29, no. 2 (2001): 319-333.

complexity of their own investments. The Church of England, for example, announced in April 2011 that it would not support the compensation system of any of the companies that are part of its \$5.3 billion investment and property portfolio if executive bonuses in those companies exceed four times their basic pay. It is unclear how the Church arrived at the 4-to-1 ratio and it would not disclose the specific companies that would not be “supported.”<sup>69</sup> Such statements are consistent with the Church’s history in promotion of economic justice, but also consistent with past statements in the sense of their rather ambiguous theological and ethical grounding. In October 2009, the Anglican Church defended its investment in the “oft-reviled pillar of the finance industry” – hedge funds – despite the fact that it had earlier criticized traders who engage in short-selling as “bank robbers and asset strippers”<sup>70</sup>; yet short-selling is commonly associated with hedge funds. To justify its investment in hedge funds the Church signed a letter along with other charitable foundations in England that contained the statement: “Maximizing the returns on our investment portfolios is an essential part of delivering our foundations’ missions, for the benefit of society.”<sup>71</sup>

The point is not whether hedge fund practices are consistent with the values and tenets of the Church of England but rather that such a criterion was apparently subordinated to profit maximization, which itself is evidence of the extent of financialization. It is also interesting that this decision came on the heels of a very bad year for the Anglican Church investment-wise, with the value of its investment portfolio dropping from English pounds 5.7 billion to 4.4 billion between 2007 and 2008.<sup>72</sup>

The Church of England remains embroiled in controversy over heavy losses from its pension plan in which all assets were invested in stock markets. In the words of pension consultant John Ralfe, the Church “just decided to go double or quits at the casino.”<sup>73</sup> This comes after charges of the Church’s financial mismanagement throughout the 1990s. By the end of 2008 its pension fund had

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<sup>69</sup> Megan Murphy and Norma Cohen, “Church Preaches Against Bonus Excess,” *Financial Times* (FT.com) [London] (April 15, 2011); accessed at <http://www.ft.com/intl/cms/s/0/f2281992-679a-11e0-9138-00144feab49a.html#axzz1RoaxHEcQ> on May 21, 2011.

<sup>70</sup> Short-selling is the practice of selling borrowed securities with the promise to buy them in the future in anticipation that the market price of securities will fall – the difference between prices at which shares are bought and sold determines profit or loss. Sam Jones, “Hedge Funds Win Church of England Blessing in Reform Fight,” *Financial Times* (FT.com) [London] (October 7, 2009); accessed at <http://www.ft.com/intl/cms/s/0/7a31f792-b2aa-11de-b7d2-00144feab49a.html#axzz1RoaxHEcQ> on May 21, 2011.

<sup>71</sup> Ibid.

<sup>72</sup> Ibid.

<sup>73</sup> Quoted in Sam Jones and Norma Cohen, “Pensions: Led Into Temptation,” *Financial Times* (FT.com) [London] (Jan. 12, 2010); accessed at <http://www.ft.com/intl/cms/s/0/8e775de8-ff1a-11de-a677-00144feab49a.html#axzz1RoaxHEcQ> on May 23, 2011.



declined to a shortfall of English pounds 352 million.<sup>74</sup> The Anglican Church, as many institutions, was caught up in an investment hysteria that fostered the attitude that big money could be made quickly with little risk. The fact that the Church of England's pension fund was invested more aggressively than those of similar organizations even as it was criticizing investment practices that undoubtedly were represented in its portfolio illustrates both the allure of easy profits and the complexity of the problem. According to Bartley and Barrow the problems of the Church of England demonstrate a "dislocation of financial decision making from integral mission and economic justice, which is both practically and theologically deficient."<sup>75</sup> One question is how Christian and other religious institutions can avoid financial practices that may violate their values in a climate of rising financial sophistication where all organizations see maximizing return on investment as necessary to survival. On the answer to that question hinges perhaps a larger one: whether religious traditions can make a positive contribution to economic ethics by developing theological and moral principles to guide believers in investment decisions and commercial activity generally.

#### THEOLOGY OF THE "REAL ECONOMY"

The relationship of theology and economy is not generally obvious although for some the connection is unmistakable. Catholic lay theologian Jung Mo Sung states that "every economy comprises implicit theological assumptions."<sup>76</sup> Some fringe Christian groups such as the Reconstructionists have contributed extensive theological treatises on economics and finance.<sup>77</sup> Mainstream American Christianity too has seen a far closer relationship with the economic establishment in the past than exists today. Robert Nelson observes the theological origins of the American Economic Association, noting that 20 of the AEA's founding members "were former or practicing ministers" and that one of the most prominent of that group, Richard T. Ely, viewed the teaching of economics as a "religious subject"

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<sup>74</sup> Ibid.

<sup>75</sup> Jonathan Bartley and Simon Barrow, "Where is the Church of England's Heart Invested?" accessed at [http://www.ekklesia.co.uk/research/church\\_of\\_englands\\_investments](http://www.ekklesia.co.uk/research/church_of_englands_investments) on 7 July 2011. Bartley and Barrow are co-directors of Ekklesia, a think-tank that explores issues of religion and society.

<sup>76</sup> Quoted in Dora Canales Núñez, Chile, "Gender and the Economy: Contributions to the Renewal of the Mission of the Church," p. 17; accessed at [http://warc.jalb.de/warcajsp/news\\_file/doc-465-1.pdf](http://warc.jalb.de/warcajsp/news_file/doc-465-1.pdf) on 7 July 2011. The paper was a contribution to the report on "Covenanting for Justice in the Economy and the Earth: Latin American Consultation on Gender and Economic Justice" held at Matanzas, Cuba, 21–27 November 2001.

<sup>77</sup> Christian Reconstructionist Gary North headed the Institute for Christian Economics for 25 years and authored countless books including *An Introduction to Christian Economics* (Nutley, N.J.: Craig Press, 1976 [c1973]). One of North's themes in these books was demonstrating common economic principles between Christianity and the Austrian economic tradition.

that should take place in formal academic departments of the nation's divinity schools.<sup>78</sup> In practical terms, Social Gospel preachers and theologians responded to the Great Depression by lobbying for the Emergency Banking Act of 1933; the legislation enabled the Reconstruction Finance Corporation to purchase approximately one-third of American bank stock in the attempt to avert financial crisis.<sup>79</sup> Active involvement of theologians in academic economics and professional institutions is no longer common. Mark Nixon suggests there has been "renewed attention to the relationship between theology and economics" in particular during the pontificate of Pope John Paul II,<sup>80</sup> but constructive economic theologies that articulate theological perspectives on what economy is for are rare. The Balkanization of disciplines likely has contributed to the separation of theology and economy. Regarding finance in particular, the Christian Church's prophetic voice has been tested as higher demands are placed on technical expertise and as churches have been drawn into investments that are increasingly difficult to comprehend and thus to reconcile with their doctrines and values.

Christians may recognize the good of finance from the perspective of faith even while disagreeing on technical aspects of its implementation. Pope Benedict recognizes the good of "ethical finance" even as he sees the need for a "sound criterion of discernment" to provide consistency in its identification.<sup>81</sup> There is concern, however, that financial practices are changing more rapidly than the ability of religious ethicists to assess their moral implications. Derivatives, hedge funds, and certain securitized investments embody practices subject to common religious criticism of the financial system. But what about investing in companies that have been accused of excessive compensation for executives? Or investment in companies that *in hindsight* engaged in "risky" financial practices because they considered them necessary for survival? How can religious investors and faith-based fund managers wade through the maze of financing procedures and determine which are consistent with their traditions? Would every major bank in the U.S. have been off limits to groups of religious investment funds three years ago if we knew then what we know now? Some of the practices that are reflected upon today as financially reckless and ethically suspect were until recently thought to contribute to stable and real economic growth.

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<sup>78</sup> Richard T. Ely, *Social Aspects of Christianity and Other Essays* (New York: Thomas Y. Crowell, 1889), pp. 15, 53, 73; cited in Robert H. Nelson, *The New Holy Wars: Economic Religion versus Environmental Religion in Contemporary America* (University Park, PA: Pennsylvania State University Press, 2009), 24.

<sup>79</sup> Gary Dorrien, "Financial Collapse: Lessons from the Social Gospel," *Christian Century* (30 December 2008): 28-30.

<sup>80</sup> Mark Nixon, "Satisfaction for Whom? Freedom for What? Theology and the Economic Theory of the Consumer," *Journal of Business Ethics* 70 (January 2007): 41.

<sup>81</sup> Benedict XVI, no. 45.

Some might contend that the present financial crisis has exposed the estrangement of economy and theology. Financialization confronts religious ideals of the human person with the reality that some individuals can thrive in a materialistic sense without need for tradition or moral reflection on economic action. Recent instability suggests that there are questions not only of individual morality but also social sustainability with respect to this assumption. Theologically based definitions of real economic production are needed to help guide adherents in consumption and investment decisions and to provide substance to criticism of financialization by religious leaders. Such visions of economic life are essential in challenging a value-neutral, positivistic science of economics that has emerged as perhaps the most defining aspect of modernity.

Theologies of the real economy necessarily will engage what constitutes tangible contribution and just reward; and real contribution implies work toward some end consistent with the values and principles that are the ground of these theologies. Such is the basis for common religious prohibitions of investment in firms that engage in pornography or gambling. Financialization has revealed the need to go beyond proscriptions of certain behaviors – constructive theologies are needed that demonstrate what economic action is for in development of individual and community. Many are convinced of the ethical root cause of the present crisis while lacking the ability to pinpoint specific transgressions that have led to it. Unlocking the religious imagination can help bring out deficiencies of the present financial system in ways that cannot be accomplished through human reason alone. As Gerard Magill observes, “the religious imagination suggests a distinctively theological way of reasoning in ethics” through employment of metaphor, development of images, claims to objective truth and other means that draw “an inseparable connection between the economy, labor, and personal flourishing in the Christian realization of the image of God.”<sup>82</sup> Theology exposes the frequent ungroundedness of economic action and the need to preserve teleology in all human activity.

In *Divine Economy: Theology and the Market*, Long observes the early development of something like a theology of the real economy in Christian tradition. Contrary to the modernist critique, he notes how the “conquering of the usury prohibition” by economics was not simply a matter of overcoming medieval theologians’ economic ignorance. There was recognition even by Aquinas of the possibility that money could be made in lending. Usury objections by the Thomists sought to preserve the “connection between one’s labor and one’s compensation,”<sup>83</sup> which in turn was essential to preserving social relationships and real economic production. Importantly, the Scholastic tradition sought to

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<sup>82</sup> Gerard Magill, “Theology in Business Ethics: Appealing to the Religious Imagination,” *Journal of Business Ethics* 11: 129, 132, 133.

<sup>83</sup> Long, 238-239.

ensure that no individual participants were unduly saddled with the risks of economic activity. Nixon shows how property ownership in Thomist economics contributed to the flourishing not only of the individual but of society by enabling people to care for what they own, promoting social order, and preventing conflict over objects of possession through clearly assigned ownership rights.<sup>84</sup> This aspect of Christian tradition is thus consistent with what Freeman sees as the two principal objectives of financial economics: 1) to spread risk among participants such that no particular individuals or institutions are burdened with risk that is unbearable and 2) efficiently direct capital to areas where it is most productive.<sup>85</sup> These goals are highly consistent with most Judeo-Christian and Islamic traditions.

Contributors to a theology of the real economy should be wary of past tendencies to closely align religious norms with those of various forms of political economy. Long has been critical in the past both of liberation theology that allies itself too closely with Marxism as well as the kind of emergent and largely conservative, pro-market theology in that both “employ an *analogia liberatis* as the decisive site where God can be recognized.”<sup>86</sup> In these views, human liberation, with or without need for revolution, is the closest the human person can come to understanding God. Long believes that the path to true development should more follow in method the work of Bernard Dempsey and Alisdair McIntyre and their reliance on an “ancient notion of a ‘functional economy’” that emphasizes virtue, intermediate institutions, and subsidiarity in social relations as “an alternative to modern economics.”<sup>87</sup> Dempsey, the Jesuit priest and Harvard-trained economist, built upon the Scholastic theologians’ distinction between interest and usury in his explorations of modern economies, and he emphasized preservation of “value relationships” in exchange by preventing their distortion by monetary forces.<sup>88</sup> The key is ensuring that money exchanged for goods corresponds to the actual values held by participants to transactions. Exchanges where asset complexity is so great as to be near incomprehensible or where the time an asset is held is so brief that the owner cannot truly value it in any meaningful way appear to violate Dempsey’s value theory by allowing “the possibility of an income which was never earned” and the possibility for future gains based on that unearned income. According to Dempsey,

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<sup>84</sup> Nixon, 52.

<sup>85</sup> Freeman, 165. Freeman cites Robert J. Shiller, *The New Financial Order: Risk in the 21<sup>st</sup> Century* (Princeton, N.J.: Princeton University Press, 2003), 1, regarding the spreading of financial risk.

<sup>86</sup> Long, 6.

<sup>87</sup> Long, 208, 209, 218.

<sup>88</sup> Long references Bernard Dempsey’s *Interest and Usury* (Washington: American Council on Public Affairs, 1943) in “Bernard Dempsey’s Theological Economics: Usury, Profit, and Human Fulfillment,” *Theological Studies* 57 (1996): 701.

If money does not so change hands as to express accurately these value relationships [of physical objects], then the relations themselves are altered rather than expressed by the money sums paid for them. When investment is made with funds that have never been income and, before being income, have never been cost, such a derangement is theoretically inevitable.<sup>89</sup>

This statement describes a primary objection to financialization by Christian critics – that money is made (or lost) with funds that are not generated income by the investor and where there is no sacrifice to the investor. It is also the necessary starting point in defining the real economy: any system of real economic production must provide that monetary exchange represents participants' actual values. Complex monetary systems often distort values and whirl out of control in their detachment from real production. Real production involves real risk and contribute toward some vision of the good grounded in institutional and individual values; and real exchange ensures that those values are accurately expressed.

Complex monetary instruments often create an illusion of security and risk-free profit, and because they often lack grounding in savings or real assets of any kind, have virtually unlimited possibilities for expansion. Dempsey was largely in agreement with Austrian economist Ludwig Mises that there are some types of "fiduciary media" where "no natural limitations exist" on the quantity of its production.<sup>90</sup> Long notes that while for Mises this was simply the working of a market economy, for Dempsey such a process of unlimited fiduciary expansion was "institutional usury."<sup>91</sup> Long describes Dempsey's theory of the way in which forms of "circulation credit," where no sacrifice is required of its issuers, limits development of both worker and society:

Once profit on investment is separated from savings, it is also separated from one's work. Perfection of personality cannot occur, and the economic life is reduced to a large lottery system where profit can be made, but this profit will have no connection to a person's proper work or function.<sup>92</sup>

For Dempsey what is real in economic life are those activities that contribute to the development of human personality, and his Catholic orientation insisted that such development must take place in community. His statement also suggests that the process we have described as financialization – where profit increasingly is based on leverage rather than real assets with quantifiable risks, and where returns

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<sup>89</sup> Dempsey, *Interest and Usury*, 207; quoted in Long, "Bernard Dempsey's Theological Economics," 702.

<sup>90</sup> Long, "Bernard Dempsey's Theological Economics," 703.

<sup>91</sup> *Ibid.*

<sup>92</sup> *Ibid.*, 705.

come more via a lottery-like system than based on tangible production – prevents the development and perfection of human personality.

Canadian Jesuit Bernard Lonergan, lamenting the lack of basic understanding of economic action in his day, stated: “When people do not understand what is happening and why, they cannot be expected to act intelligently. When intelligence is a blank, the first law of nature takes over: self-preservation.”<sup>93</sup> Lonergan insisted that union of ethics, economics, philosophy, and theology was necessary for the preservation of democracy itself. Economic intentionality must be preserved for the development of virtue and of intelligent, moral actors in self-sustaining democratic polities. True development depends on achievement of harmony among many disciplines in a “system” that preserves intelligent, moral action.

New theologies are needed to engage the issues at the heart of the present crisis: risk, return, scarcity, efficiency, financial complexity, and contribution/reward. These concepts are changing rapidly and require ongoing theological reflection to understand their consequences for virtue development, economic sustainability, and religious tradition itself. Niels Gregersen provides a possible path forward in development of a “theology of risk taking” that while not specifically addressing finance, shows that the “concept of risk is intrinsically coupled with the concept of complexity” and that globalization of risk has resulted from vast systemic interdependencies.<sup>94</sup> Christian theologians have too often fallen into the modernist trap of assuming lack of connection between risk in the physical (including financial) world and the spiritual insights of their faith traditions. Gregersen destroys the assumption by illuminating “a surprising field of interactions between theology, the natural sciences, and the social sciences.”<sup>95</sup> The starting point for a theology of risk is the understanding that certainty does not exist in the material world; purposeful action necessarily incurs the possibility of failure or even danger to one’s well-being. Risk is inherent in all human undertakings but the “nature of risk” associated with unique investment methods and instruments will vary vis-à-vis Christian ethical perspectives. As Gregersen observes, the early Church itself was an institution at risk, nomadic in origins and subject to perpetual danger as an alien society in the Roman Empire. The Disciples gave up what worldly security they possessed to follow Jesus. The very history of Christianity demonstrates that communal risk sharing is a fundamental to the faith because “in an interconnected world, risks are shared risks, and the

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<sup>93</sup> Bernard Lonergan, *The Collected Works of Bernard Lonergan*, vol. 15, *Macroeconomic Dynamics: An Essay in Circulation Analysis*, ed. Frederick Lawrence, Charles Hefling and Patrick Byrne (Toronto: University of Toronto Press, 1999), 82.

<sup>94</sup> Niels Henrik Gregersen, “Risk and Religion: Toward a Theology of Risk Taking,” *Zygon* 38, no. 2 (June 2003): 356.

<sup>95</sup> *Ibid.*, 357.

Creator did not withdraw from the ethics of sharing risks, even to the point of death.”<sup>96</sup>

Philip Goodchild has proposed a “theology of money” that explores how money impacts the society in which it exists: the politics surrounding and the means by which it shapes social relationships. He sees reform of the monetary system as a necessary part of what he calls “the new theological agenda.” Goodchild sees the boundaries established by money’s finite nature being overcome through rising levels of credit and debt. We deny the limitations imposed by fixed monetary resources through endless generation of credit, but this has led to the “demonic hold that debt has over our lives.”<sup>97</sup> Debt is not simply a rational issue but a spiritual one as well, as shown in the Judeo-Christian concept of the Jubilee, which acknowledges limits on debt and property rights grounded in an overarching view of Creation. Theologies of financial intermediation may engage scriptural resources on capital formation that demonstrate principles by which resources were allocated in early Christian communities. Certainly relevant for Christians is The “Parable of the Talents” (Matthew 25:14-30; Luke 19:11-27) where the risk-averse servant who buries his talent in the sand is punished by the master while the other two who traded theirs and received the additional rewards from the master. This parable has implications for concepts like entrepreneurship and responsible risk-taking. New explorations of Luke 16 are needed to address the call for responsible administration of wealth (Luke 16:11) and the pronouncement that no one can serve both God and money (Luke 16:13).

Human flourishing that is the goal of the real economy requires extensive institutional support. Theologian William Cavanaugh observes that “the modern bureaucratic state” is incapable of providing “real answers about true human flourishing”<sup>98</sup>; thus, citizens seek their own models of fulfillment beyond the state – that is the idea behind liberalism. Such a system depends on intermediary institutions to fill the void between the individual and state in promoting personal development and the social good. The modern corporation is ill-suited to such a task as well – indeed, financialization has only intensified focus on its own survival – and other intermediary associations have declined in importance with the rise of economic globalization. Religious institutions are unique in their concern for human development, providing definition to holistic flourishing not

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<sup>96</sup> Ibid., 374.

<sup>97</sup> Philip Goodchild, “Economic Life is Constrained by the Perpetual Need for Making Money,” [interview on his book *The Theology of Money* (London: SCM Press, 2007)]; accessed at [http://www.rorotoko.com/index.php/article/philip\\_goodchild\\_book\\_interview\\_theology\\_of\\_money/P1/](http://www.rorotoko.com/index.php/article/philip_goodchild_book_interview_theology_of_money/P1/) on 7 July 2011.

<sup>98</sup> Cavanaugh, “Commentary: Theology and Economy,” *Religion and Ethics Newsweekly*, Episode no. 1206 (October 10, 2008); accessed at <http://www.pbs.org/wnet/religionandethics/week1206/exclusive.html?print> on June 16, 2011.

simply material success. Theologies are capable of defining real production in ways that avoid getting drawn into the drone of criticism that leads nowhere because it has no vision. At least theoretically, what Christianity, as well as Judaism, Islam, and other traditions bring to the table in this debate *is vision*, and histories of ethical construction that inform economic life.

Cavanaugh sees the problem at the heart of financialization not as one of greed and materialism but rather as the human desire to “transcend material constraints” altogether. According to Cavanaugh, it is a phenomenon where consumers and investors seek *creatio ex nihilo* (creation out of nothing), a process that only God can accomplish:

The desire to transcend material limitations is perhaps most powerfully reflected in the multiple ways that the global economy has gotten detached from reality. The ubiquitous practice of maximum leveraging is basically an attempt to build assets out of debt – which is to say, out of nothing at all.<sup>99</sup>

The perspective of classical economics is flawed, according to Cavanaugh, in viewing economics as a “tragic” conflict resulting from “the infinite nature of human want” being perpetually constrained by the “finite nature of material resources.”<sup>100</sup> The core problem is denial of the spiritual nature of economics and engagement in a “fantasy that people can be free from vulnerability, that profit itself can be made risk-free.”<sup>101</sup> Cavanaugh grapples theologically with basic economic principles – scarcity, risk, trust – in ways that point toward a fundamental reorientation of economic life that embraces its spiritual dimension. He posits that the financial crisis was not precipitated by the “failure of trust” noted by analysts but rather “more fundamentally on the attempt to overcome the necessity of trust.”<sup>102</sup> Trust in Smithian market economics is sustained through the value of reputation, but the impersonal nature of the global economy combined with the increasingly casual acceptance of bankruptcy, bailouts, and other procedures grounded in political authority have lessened the power of reputation to engender trust. Even worse, “profit can be made from distrust itself, by offering to guarantee loans between mutually suspicious parties.”<sup>103</sup> Theological development of real economic principles begin by addressing the loss of trust in economic life.

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<sup>99</sup> William Cavanaugh, “Only Christianity Can Save Economics,” *ABC Religion and Ethics* (15 April 2011); accessed at <http://www.abc.net.au/religion/articles/2011/04/15/3192406.htm> on 3 June 2011.

<sup>100</sup> Ibid.

<sup>101</sup> Ibid. Cavanaugh notes how “governments around the world have helped to perpetuate this fantasy. Their role in the crisis was to absorb risk, to bail out the most reckless with borrowed money, which is only to defer the consequences of risk to some later time.”

<sup>102</sup> Ibid (Emphasis in the original).

<sup>103</sup> Ibid.



Cavanaugh points to perhaps the most fundamental aspect of the crisis and one to which Islamic economists almost universally have called attention where he states “there is no divide between spiritual and economic matters, and the biblical writers would have found any such divide to be perverse or completely unthinkable. They recognized that there is a ‘spirituality’ embedded in all kinds of economic practice, whether we acknowledge it or not.”<sup>104</sup> Moreover, he cautions against overreliance on the state to extricate us from problems; the state today is more “enabler” rather than problem solver, looking to “pick up the pieces when reckless market behavior leads to disastrous consequences.”<sup>105</sup> This observation reflects a crisis of expectation where “people do not so much look to the state to defend them against corporate power and financial predation – they look to the state to defer the consequences of a sick economy to some future time.”<sup>106</sup> Positive change in the economic culture must come from non-state institutional sources that have the potential to reorient human expectations toward particular conceptions of human flourishing.

Christian theologies of the real economy will vary in content. Hollenbach suggests that even among Catholic orders “differing emphases of spirituality” means that these traditions will “have different perceptions and emphases in their relation to society and in their use of material goods.”<sup>107</sup> Methods for development of economic theologies, however, will have much in common, involving:

- Exploration of religious texts and human experience to better understand the purpose of economic action
- Interpretation of contemporary economic experience in “an explicitly transcendental or metaphysical mode of reflection”<sup>108</sup>
- Derivation of theological principles applicable to immediate economic contexts
- Application of these principles to real world situations in the practice of “critical theology”<sup>109</sup>

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<sup>104</sup> Ibid.

<sup>105</sup> Ibid.

<sup>106</sup> Ibid.

<sup>107</sup> David Hollenbach, “Corporate Investments, Ethics, and Evangelical Poverty: A Challenge to American Religious Orders,” *Theological Studies* 34, no. 2 (1973): 271.

<sup>108</sup> “An explicitly transcendental or metaphysical mode of reflection” are David Tracy’s words describing the practice of “revisionist theology” taken from his *Blessed Rage for Order: The New Pluralism in Theology* (New York: Seabury Press, 1975), 52; quoted in Gareth Jones, *Critical Theology: Questions of Truth and Method* (New York: Paragon House, 1995), 118.

<sup>109</sup> Jones describes critical theology as “a theoretical argument concerning Christian talk about God in the contemporary world.” See Jones, 1.

Terminology is critical for the development theologies of the real economy. The term “real” as applied to economic life will have different meanings for different persons. For the professional economist the word typically denotes inflation-adjusted measures of income and production, but for those practicing theological economics it describes action that contributes to human actualization viewed from an expressly religious perspective. A theology of the real economy must blend systems of natural justice with what T. S. Eliot described as “the natural end of man – virtue and well-being in community – [that] is acknowledged for all, and the supernatural end – beatitude – for those who have eyes to see it.”<sup>110</sup> Financialization today threatens such religious conceptions of the human person.

Writing on his blogspot, Rice University economics professor Mahmoud Gamal suggests that forbidding and permitting certain financial practices based on Islamic jurisprudence in an era of “financial engineering” is “incoherent” and ultimately self-defeating. Gamal does not deny that religious teaching might work to place societies on financial paths that ultimately are more sustainable but he suggests that attempting to force a society on a more sustainable path is a losing proposition:

Careful and equitable societies get cannibalized by greedy and fast growing ones. As they say in finance, “the market can stay irrational longer than you can stay solvent.” Likewise, fast growing societies can continue their unsustainable growth path long enough to destroy other societies on more sustainable paths. That is why we need a global social contract on sustainable growth and prudent finance.<sup>111</sup>

Gamal is likely correct that economic competition will weed out non-competitive traditional values. Markets are subject to deterministic forces such as the rise in complexity, concentrations of power, asymmetric information, and other factors that have contributed to the crisis. But practices promoting financialization have come to be known *ex post* for the most part. Theologies of the real economy and their influence on faith-based investment offer possibilities for dealing with phenomena like financialization, but only if they are able to develop rules to guide financial activity. The complexity involved in these determinations, much as the complexity involved in finance itself, will be immense. But such complexity insists that it must begin from a theological foundation or it will inevitably founder.

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<sup>110</sup> Quoted in V. A. Demant, “Christian Ethics and the Welfare State,” *Cross Currents* vol. 3, no. 1 (Fall 1952): 7.

<sup>111</sup> Mahmoud El-Gamal, “‘Islamic Economics’ and the Financial Crisis,” October 11, 2008; accessed at <http://elgamal.blogspot.com/2008/10/islamic-economics-and-financial-crisis.html>.

Can any global social contract of the kind Gamal proposes be accomplished? Dominance of an intense international competitive ethic among nations seems to preclude such agreement. A bottom-up ethical transformation of financial culture – while perhaps still a long-shot – would seem as likely as the transformation of international political economy through social contract. In the end it is the values of participants that must change to prevent future financial crises of the kind we are witnessing.

In 2004, members of the World Alliance of Reformed Churches came together in Accra, Ghana to discuss and respond to the challenges of globalization. They developed unique theological perspectives on the problems of the global economy.<sup>112</sup> An even broader ecumenical discussion is needed today to address the spiritual and moral effects of financialization and to bring to light its potential impacts on economic sustainability, virtue development, and religious tradition. Refining what are largely theologically ungrounded criticisms into constructive arguments reinforced by tradition may contribute to grassroots transformation of the global investment culture. Perceived limits to “secular” regulation and the possibility for unintended consequences in regulatory reform suggest the need for changes *within* the market culture in establishing a stable and ethical foundation for the world economy. Richard Freeman contends that a lesson of the recent crisis is that “reforming finance will be an uphill battle requiring the countervailing power of groups outside the sector in order to succeed.”<sup>113</sup> That countervailing force cannot be realized only in the form of government regulation, which has proven insufficient to maintain financial stability. Members of the U.S. House of Representatives reinforced this point in July 2011 when they “peppered U.S. regulators” about the need to raise capital requirements for American banks.<sup>114</sup> Representatives, apparently fearing the consequences for the international competitiveness of the American banking industry, have been reluctant to raise capital requirements despite the painfully obvious observation that inadequate bank capital has been a fundamental source of present problems. Freeman notes that “regulatory and political failure to act should not be viewed as some factor exogenous to the crisis” for regulatory inaction and ineptitude have resulted from the embedding of regulatory authorities

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<sup>112</sup> See papers from some of the contributors at [http://warc.jalb.de/warcajsp/news\\_file/refworld55N3Nov21.pdf](http://warc.jalb.de/warcajsp/news_file/refworld55N3Nov21.pdf).

<sup>113</sup> Freeman, 179.

<sup>114</sup> Nocera notes that the international competitiveness argument against higher capital requirements for U.S. banks “deserves particular scorn” because European banks, in particular, are much worse off in terms of the capital they hold than American banks. The implication is that the U.S. could raise capital requirements to somewhat responsible levels without significantly affecting their competitive position vis-à-vis their European counterparts. See Joe Nocera, “The Banking Industry’s Moment of Truth is Now,” *The New York Times* (June 20, 2011); accessed at <http://www.nytimes.com/2011/06/21/opinion/21nocera.html> on 22 June 2011.

in a highly politicized economy that is inclined toward preserving the status quo.  
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There are certain ways in which religious perspectives on our financial problems “see beyond” the technical critiques of economists and market analysts to the heart of the crisis. Development of theologies of the real economy from the perspectives of different faith traditions can inform discussions concerning the reestablishment of ethics and stability to the global economy and offer guidance to millions of investor-adherents worldwide. An immediate need is the reorientation of finance through development of theology centering on real economic activity – not simply calls for the elimination of injustice but constructive theological dialogue on what the financial economy is for. Financialization is more insidious than government corruption or corporate collusion. Its destructive consequences result from natural patterns of economic development and the rational incentives of participants that go beyond even the most devious intentions of any government, corporation, or social class. Its reversal cannot be accomplished through government regulation or appeals to corporate responsibility. Fundamental transformation of the investment culture is needed.

## CONCLUSION

One reason for the hopeful contribution of religious traditions in stabilizing the global economy concerns the apparent limits of secular alternatives. Stiglitz observes that transparency was *a cause* but not *the cause* of the crisis; greater transparency can “ensure that incentive structures do not encourage excessively risky short-sighted behaviour” but that alone will not solve the problem.<sup>116</sup> Allen and Yago see complexity as a major villain,<sup>117</sup> but one must ask how complexity is effectively reduced in financial markets. What will be the regulatory or market force that rewards those financial firms that create instruments of greater simplicity? Will governments be able to force reduction in complexity and greater transparency on financial firms? Additional government regulation in the attempt to achieve simplicity is a virtual oxymoron. No regulatory framework is capable of harnessing a financial system incentivized toward more speculative investment based on increasingly complex instruments; moreover, regulation inevitably risks unintended consequences.

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<sup>115</sup> Ibid., 178.

<sup>116</sup> Joseph Stiglitz, “A Crisis of Confidence,” *Guardian* (22 October 2008); accessed at <http://www.guardian.co.uk/commentisfree/cifamerica/2008/oct/22/economy-financial-crisis-regulation> on 14 March 2011.

<sup>117</sup> Allen, F. and Yago, G., *Financing the Future Market-Based Innovations for Growth* (Upper Saddle River, NJ: Wharton School Publishing, 2010); cited in Zaharia, et al, 286.

Mortreuil makes the rather outlandish comment that “regulation must lead to virtuous behavior, which is quintessential to virtuous culture.”<sup>118</sup> It is difficult to believe that virtue can be reestablished through regulatory reform. One might assume that more modest goals of transparency and fair play will do as regulatory aims for the present. But Mortreuil’s point is apt in suggesting that virtue must come from somewhere.

Much as Lazonick observes that the real culprit in the crisis was a transformation in the culture of corporate investing that spread speculative behavior to many players in the American economy, so too it will likely take another reformation of the investment community to reestablish stability. Looking to regulatory schemes to “save us from ourselves” as financial complexity increases will be massively expensive and, in the end, likely ineffectual. Worse, it may open new opportunities for those willing to exploit information asymmetries, concentrations of market power, legal loopholes and inexact ethical boundaries for the achievement of greater financial gains.

While casting about for villains in the crisis, one should remember that financialization results as much from the demand as the supply side of the equation. It is consumers who insist on unrealistic returns as much as the professionals in financial services who devise intricate instruments to achieve those returns who today protract the problem. If we continue to expect that “industrial activities may generate a 5 percent margin, while financial services *should* generate a 15 percent margin,”<sup>119</sup> then we should be unsurprised when investors act recklessly, salespersons act deceptively, and the entire system degenerates ethically. This also is the principal reason why regulation has limits; just as in the War on Drugs, attempts to restrict supply in conditions of high demand will lead only to massive expenditure, continued conflict, and inequity in reward. Those who seek lavish returns commensurately with minimal risk and economic justice often chide the ineffectiveness of the regulatory regime, but the very need for regulation comes from those unrealistic demands. Religion is an institution uniquely positioned to ground investor expectations in ways that can be more effective than acts of regulatory agencies.

Religion’s contribution to the reinvigoration of economic ethics must go beyond moralizing. There will be over-the-top criticism such as the Archbishop of Westminster’s words comparing the compensation of financial professionals to the pedophile priest scandal of the Roman Catholic Church.<sup>120</sup> But positive theological development of what constitutes real economic development is what is

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<sup>118</sup> Laurent Mortreuil, “The Current Crisis: Who Is To Blame?” *Journal of Management Development* 29, no. 7/8 (2010): 648.

<sup>119</sup> Mortreuil, 651 (emphasis added).

<sup>120</sup> Megan Murphy, “Bad Actions Stick, Archbishop Tells City,” *Financial Times* (London), October 5, 2010, 2.

needed. The “meaningful engagement of theology and finance” is no longer some disciplinary oddity to be pursued at the margins of academia; “investment theologies” are needed not only to help adherents navigate the maze of investment choices but also to contribute to a much-needed reformation of the financial economy. These theologies must be based on more comprehensive theologies of the real economy that identify types of economic activity that are consistent (and inconsistent) with the values and practices of faith traditions. There is need for theologies of scarcity, risk, etc., as those outlined by Cavanaugh across traditions to guide investors desiring to express their values through capital. Religious organizations should not only foster such development but apply it within their own portfolios to provide institutional witness to the possibility of religious investment.

We are left with Gamal’s observation that nation-states (and presumably the institutions within them) that do not seek to maximize return based on economic criteria will be outcompeted and eventually extinguished. But financialization has revealed that attempts at short-term maximization may lead to long-term instability. Might religious investing help combat short-termism and help elongate the time horizon for profitability assessments? Religious determinations of real economic activity are inherently teleological in a way that secular assessments are not. They point toward measures of “good” consistent with traditional values and practices. In this way, theologians and ethicists can make unique contributions toward eradicating financialization but only if they offer definition to what constitutes real production.

Whether theology can aid the “de-financialization” of the global economy remains to be seen. Identifying those practices that contribute to financialization and devising theological principles to address them will be difficult. Religious critics are right to see financialization as a major problem – perhaps the major financial problem of our age. They are also to be commended for seeking to combat it. Truly tackling the problem requires theological and ethical development to consistently articulate what is real and what is illusory in economic life – particularly in the labyrinth that is contemporary finance. Individual believers have the responsibility to become educated in financial practices and their traditions’ assessments of those practices. Perhaps the best way for religious investors to reverse the trend of financialization is, consistent with evangelical Charles Colson’s advice, simply to be faithful to their own traditions – to become investor witnesses.<sup>121</sup> In this way they engage a means of self-empowerment that should be both a spiritual and natural response to the intricacies of the financial society.

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<sup>121</sup> Charles Colson, “God Is In Control During the Financial Crisis,” *Christianity Today* (October 2, 2008); accessed at <http://www.christianitytoday.com/ct/2008/octoberweb-only/140-42.0.html?start=1> on 6 June 2011.