

# Truth, Charity, and the Dismal Science: An Economist's Response to *Caritas In Veritate*

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## Abstract

In *Caritas In Veritate* Pope Benedict XVI decries the present state of the world socially, politically, economically, and judicially. He sets out what should be so that each and every person can attain authentic human development, rather than remain mired in physical or spiritual poverty. While *Caritas In Veritate* calls upon economies, governments, and institutions to be and to do more, it fails to provide direction in terms of specific, feasible, incentive compatible socio-economic policies by which these goals can be achieved. By identifying the essential message of *Caritas In Veritate*, from the perspective of economics rather than theology, this article determines whether or not the temporal human development goals can be achieved, and if so, how.

## Keywords

charity, common good, economics, societal welfare, truth

In *Caritas In Veritate* Pope Benedict XVI decries the present state of the world socially, politically, economically, and judicially, and sets out what should be so that each and every person can attain authentic human development rather than remain mired in physical or spiritual poverty.<sup>1</sup> It is first and foremost a theological document exhorting Catholics and all people of good will to live life as God intends in charity and truth. It is aspirational rather than practical. It calls upon economies, governments, and institutions to be and to do more, bypassing worldly constraints by appealing to

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1 This article is an updated version of a paper given at a conference on the Encyclical *Caritas in Veritate* at St Patrick's College, Maynooth, 16 February 2010. See *Caritas in Veritate* (Dublin: Veritas, 2009).

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the transcendent and to an eschatological vision, the City of God on earth. Can it, then, provide direction in terms of socio-economic policy, at the local, regional, national, and international levels, which might be promulgated, organized and funded by governments, both individually and collectively? The answer provided in *Caritas In Veritate* itself would appear to be no.

Development, social well-being, the search for a satisfactory solution to the grave socio-economic problems besetting humanity, all need this truth. What they need even more is that this truth should be loved and demonstrated. Without truth, without trust and love for what is true, there is no social conscience and responsibility, and social action ends up serving private interests and the logic of power, resulting in social fragmentation, especially in a globalized society at difficult times like the present.<sup>2</sup>

In terms of the socio-economic goals to be achieved, I will provide an alternative vision by identifying the essential message, from an economist's rather than a theologian's perspective, and then determine whether these temporal goals can be achieved, and if so, in what manner.

## The Dialogue between Charity and Economics

To place this discussion in context, it is necessary to provide definitions of key concepts used in the document that are seldom considered in economics (or by economists), yet which underlie the interdisciplinary connections between the theological imperatives of truth and charity and the quotidian preoccupations of economics. Succinct definitions of truth and charity are found in the *Catechism of the Catholic Church*:

The Old Testament attests that God is the source of all truth. His Word is truth. His Law is truth. His 'faithfulness endures to all generations.' Since God is 'true,' the members of his people are called to live in the truth.<sup>3</sup>

And

In Jesus Christ, the whole of God's truth has been made manifest. 'Full of grace and truth,' he came as the 'light of the world,' he is the Truth. 'Whoever believes in me may not remain in darkness.' The disciple of Jesus continues in his word so as to know 'the truth [that] will make you free' and that sanctifies. To follow Jesus is to live in 'the Spirit of truth,' whom the Father sends in his name and who leads 'into all the truth.'<sup>4</sup>

Charity is 'the theological virtue by which we love God above all things for his own sake, and our neighbour as ourselves for the love of God.'<sup>5</sup> Economics is 'the [social] science which studies human behaviour as a relationship between ends and scarce means

2 *Caritas in Veritate*, 5.

3 *Catechism of the Catholic Church* (Vatican: Libreria Editrice Vaticana, 2000), 2465.

4 *Ibid.*, 2466 (emphasis original).

5 *Ibid.*, 1822.

which have alternative uses.<sup>6</sup> Because of scarcity, choices must be made, and these choices are informed by incentives, be they economic or social, community or individual, temporal or eschatological, and constrained by available resources. These resources may include physical goods, capital (human, social, spiritual, or physical), knowledge, technology, or the natural world.

Economics is bounded by the finite. Truth and charity exist in the infiniteness of God's love. Thus, many things are impossible for humankind, but nothing is impossible for God. And while 'God destined the earth and all it contains for all people and all peoples so that all created things would be shared fairly by all mankind under the guidance of justice tempered by charity,' it is economic decisions made by individuals, communities, religious institutions, businesses, and governments (local, regional, national, international), individually or as part of a coalition or an alliance, that govern that sharing.<sup>7</sup> These decisions, individually or collectively made, and their outcomes, remind us of what is possible on this earth and what is not.

Charity in truth defines a way of living in which the choices taken are ethical and conform to a life lived as God intended. These ethical choices define a subset from within which economic decisions, if constrained to be both ethical and feasible, can be made. Economics is essential for a life lived in charity and truth in that it defines what is possible and where gains (broadly defined to include both economic and non-economic dimensions, in human terms) are highest. Given the set of all feasible choices that are also ethical, it is thus possible to establish which choices are best if one's goal is to maximize the common good, which is the goal of a life lived in charity in truth.

The common good, as defined in *Caritas in Veritate*, is the provision of what is required so that each and every individual and all individuals collectively can develop authentically as an individual and as a member of society.<sup>8</sup> Authentic human development, living a life guided by charity in truth, is defined first from the perspective of the individual, and then from the perspective of society, writ small or large, the economy, again writ small or large, the nation or collectives of nations, and, finally, all humankind. For authentic human development to be possible, economic resources are required: first to provide subsistence at an acceptable level for each and every member of society, that is, to ensure that the basic needs of life are met; and then to enable the individual to flourish, both as an individual and as an intelligent and free member of a community, that is, to ensure the 'essential temporal resources for a sustained, meaningful, productive and

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6 Lionel Robbins, *An Essay on the Nature and Significance of Economic Science* (London: Macmillan, 1935).

7 *Gaudium et Spes*, 69.

8 This definition is echoed in the works of a number of economists who are concerned with ethical economic and social development (see Paul Streeten, et al., *First Things First: Meeting Basic Needs in Developing Countries* [London: Oxford University, 1981]; Amartya Sen, 'Development Thinking at the Beginning of the 21st Century,' in *Economic and Social Development into the XXI Century*, ed. Louis Emmerij [Washington, DC: Inter-American Development Bank, 1997]; and David Crocker, 'Toward Development Ethics,' *World Development* 19 [1991]: 457-483).

free participation in the socio-economic life of the larger community,' since through these the individual can 'mirror the gift of a divine image.'<sup>9</sup>

## A Simple Model

Can authentic human development, as defined in *Caritas in Veritate*, from the level of the individual to the level of the global community, be achieved? Can authentic human development of all individuals, local communities (which are small, in which all members know, trust and are concerned for each other, which are governed by enforceable community norms), nations (which are large groupings of individuals governed by constitutions, institutions, markets and laws, and comprised of individuals and groups thereof), international agencies (whose members are states rather than individuals), and all humankind (which is all individuals and all groups of individuals however comprised) be achieved?<sup>10</sup> I will address this question from an economic perspective. To do so, I will consider whether communities, governments, nations, or international agencies, can provide, in full or in part, the *economic requirements*, both in terms of goods and economic opportunities, necessary for authentic human development. Additionally, I will consider whether they can achieve this without explicitly considering transcendence—itsself, an essential element of living a life guided by charity in truth, as a motive in formulating socio-economic policies—while recognizing that the individuals who make up these communities, governments, nations, and international agencies may be so motivated.

To respond to these issues it is useful to enter into the world of economic analysis and consider the twin socio-economic goals of providing all members of society with their basic needs and with the opportunity to contribute freely and productively to the life of that society.<sup>11</sup> These goals must be defined, delimited, and agreed upon socially. They can differ from group to group since different societies and economies value and define these goals differently.<sup>12</sup> Such goals do not define the only set of socio-economic goals that are possible and are consistent with cultural values. Clearly, the goal of economic equality for all, in terms of income or wealth, is also possible. The goal of basic need attainment can be justified, from a purely economic perspective, if each individual in society is given more and in this sense would be better off and if the basic needs of all members of society are met. Better off can be defined in economic terms alone if in providing for everyone's basic needs the economic output of the economy is increased by more than the cost of the provision of those needs. If each individual is more productive, then more can be produced with the same inputs. The provision of the opportunity to contribute could be defined as each member of society being given a basic education or

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9 Albino Barrera, 'Degrees of Unmet Needs in the *Superfluous Income Criterion*,' *Review of Social Economy* 55 (1997): 464–486, at 475 and 470; Marcelo Sorondo, 'For a Catholic Vision of the Economy,' *Journal of Markets and Morality* 6 (2003): 7–31.

10 Samuel Bowles, *Microeconomics: Behavior, Institutions, and Evolution* (New York: Russell Sage Foundation, 2004).

11 For a discussion of the difficulty of defining essential needs, see Barrera, 'Degrees of Unmet Needs.'

12 John Whalley 'Globalisation and Values,' *The World Economy* 31 (2008): 1503–1524.

training (knowledge, skills, social norms, and expectations), which increases economic output by more than the cost of its provision. While this description of what it means to be better off may be considered by some to be quite narrow, it does establish that even on purely economic grounds these goals can have a resonance.

For concreteness, let us consider a very simple economy. This economy is made up of two types of people, the rich and the poor. We will assume, for simplicity, it exists for only two periods. Assume the rich have more than enough resources to achieve authentic human development through meeting their basic needs and providing for their own education. Assume the poor have no resources of their own (all that is required for this is that they control fewer resources than are needed to meet their societal goals).

A number of scenarios arise. In the first scenario, the rich can provide for themselves and for the poor, and, by doing so, the economy as a whole is economically better off than had the rich not provided for the poor. Thus, the economic opportunity cost of participation for the rich is less than the benefit received. In the second scenario, the rich can provide for themselves and for the poor, and, by doing so, the economy as a whole is economically better off, the poor are better off, but the rich could have done better, economically, by not participating. The economic opportunity cost of participation is greater than the benefit received. This can be rectified by the poor transferring enough of their period two resources to the rich to compensate the rich for providing for the poor in the first period. Clearly, this would require a transfer from the relatively poor to the relatively rich, but it could be justified if the first period transfer from rich to poor were viewed as a loan rather than a gift. In the third scenario, the economic outcomes are identical to those in the second scenario, but the rich receive non-economic benefits through their transfer of resources to the poor, perhaps as they value greater economic equality, or social cohesion, or neighbourliness, which results from the poor being closer to the rich in economic and social terms.<sup>13</sup> Then societal welfare, a combination of economic and social well-being, may still be higher and all may be better off. The poor could also benefit from the reduction in relative economic inequality in society, if equality is valued. In the fourth scenario, the economic outcome is identical to the first scenario: however, now the poor resent being economically beholden to the rich (even if they agree on the overall goals), thereby reducing the value of the total benefits, both economic and social, received; or they could feel that the society in which they can now participate and to which they can contribute is not so much their society as the society of the rich, with this feeling of alienation tempering the social and economic benefits derived; or contrarily, they could value the economic and social gain more highly as a result of comparing where they end economically to where they started. Clearly, these social, non-economic, benefits play an essential role in any analysis of societal welfare. The difficulty with social benefits, from a purely empirical standpoint, is that they are difficult to measure.

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13 What individuals, communities, nations, and other coalitions of individuals value depends on a myriad of influences that include religion. Knowing what is valued and how it is valued, both in economic and social terms, is essential to any calculation of welfare at the level of society.

In the fifth scenario, although the rich individually have the resources to meet their needs, the economy as a whole does not have the resources to meet its desired goals. Society, then, has two choices. It can provide a lower level of resources to the poor, perhaps ensuring their basic subsistence but providing less for education. This suggests that there is a hierarchy of needs that society wishes to meet, where providing for subsistence is the highest priority need (as it is also required to partake of education), and education (providing the means to flourish) is a lower priority need.<sup>14</sup> In this simple society, all could still be better off on purely economic terms if the economic benefits outweigh the economic opportunity costs for the rich. In economic and social terms, all could be better off if social benefits (from the improvement of the lot of the poor) are sufficient to compensate the rich for whatever economic loss is suffered. However, even if all are better off, economic and social inequalities could be greater than in the earlier scenario when the available resources enabled all goals to be met.

In the final scenario, the rich, after providing for their own needs, cannot even provide the poor with that which is required to meet their subsistence needs. In this case additional social choices must be made. Do the rich reduce the funding of their own education, thereby applying the hierarchy of needs satisfied to themselves and to the poor, while still providing only for the basic needs of the poor? For this to be welfare improving the benefit of self-sacrifice to the rich and the benefit of that same sacrifice to the poor would have to overwhelm the economic losses to the rich. Or, do the rich redefine society so as to exclude the poor, leading to social disintegration or distrust?<sup>15</sup> In this situation would a society that is comprised of both rich and poor ever coalesce so that we could consider ourselves to be neighbours?

What this simple example reveals is the complexity of achieving societal socio-economic goals. First, society is required to agree that the stated societal goals are goals worth pursuing. That is, both the rich and the poor need to agree that they are members of one society with shared goals. Here, it must, of course, be noted that agreeing that goals should be pursued is not the same as agreeing on how they will be achieved. Secondly, achieving these goals leaves no one in society worse off in some well-defined sense—either in a purely economic sense or in a socio-economic sense—than they would have been in pursuing alternative economic and/or social paths. It must be noted that being better off than one would have been if one had pursued a different path does not guarantee that one is satisfied: the poor may remain relatively poor and resent this. Members of this society—here defined as both the haves and the have-nots—freely choose to be members of this society, and this must be the case even if the decision is made prior to finding out the group to which one belongs. That is, in a dynamic context, it cannot be the case that a poor person agrees with the societal goals in period one, when he has nothing, but then withdraws his agreement in period three, when he has become

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14 Barrera, 'Degrees of Unmet Needs.'

15 Clearly, if the poor exist at a distance from the rich (say in a different country or a different region), this would be easier; consider the relationship between the nations of the developed and the developing world.

rich and is called upon to help the current poor.<sup>16</sup> Thirdly, even under the assumption of economic gains over all, initial redistributions of resources can generate both positive and negative economic and social side effects, such as greater social solidarity and improved productivity via higher average levels of human capital, or, contrarily, less social solidarity, feelings of ingratitude and beholdingness, and fewer resources controlled by the rich, even relatively, even when all agree on the ultimate socio-economic goals. These positive and negative effects may affect different groups in society differently, requiring that they be carefully balanced which may require additional resource redistributions which might in turn generate their own side effects. Fourthly, when resources are inadequate in meeting desired societal goals, those goals need to be redefined so that, given existing resources, the revised goals are achievable, or the society over which the goals are defined must be redefined so as to exclude some groups from membership. Fifthly, positive economic externalities (such as higher aggregate human capital increasing the return to education) or non-economic benefits are often required in order to achieve societal goals if it is required that all be made better off. This means that the initially better off members of society who provide the bulk of the economic resources that are required receive a positive benefit over their best alternative use of their resources, and which, itself, is comprised of economic and social benefits, or even, economic losses and social benefits. Clearly, this implies also that in order to secure high enough economic benefits from alternative uses of resources, the finite social losses imposed as a result of withdrawing from society (made up of both haves and have-nots) may be worth absorbing. 'As society becomes more globalized, it makes us neighbours but does not make us brothers.'<sup>17</sup> Society is, at best, fragile.

## From Theory to Practice

To make this discussion still more concrete I will provide a number of examples, drawn from history, current events, or amalgamations of real world situations.

### *Charity in Community*

Transfers from rich to poor so as to achieve societal goals were, during the medieval period in Europe, facilitated by the Church which, at this time, was able more effectively to promote a life of charity in truth.<sup>18</sup> DeSwaan contends that the social stability and cohesion necessary for the formation of small towns and urban centres would have been impossible without a system of poor relief.<sup>19</sup> To establish a viable system it was

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16 In more concrete terms, this means that if developed country A is going to provide developing country B with aid, both the donor country and the recipient country must agree to the aid, how it is to be distributed, and what it is to achieve, that is, the stated socio-economic goals.

17 *Caritas in Veritate*, 19.

18 Thomas DeLeire, Thomas Jeitschko, Séamus O'Connell, and Rowena Pecchenino, 'Love Thy Neighbor as Thyself: Community Formation and the Church,' *Faith & Economics* 55 (2010): 19–56.

19 Abram deSwaan, *In Care of the State: Health Care, Education and Welfare in Europe and the USA in the Modern Era* (New York: Oxford University, 1988).

necessary to ensure that all involved played their part. This required an agreed set of rules, trust (that if you played by the rules you would receive your reward), oversight, and persuasion (to preclude cheating). Ensuring that these requirements were met fell to the clergy. Those providing the charity did so for reasons both practical (personal and economic security) and spiritual (the prayers of the recipients of their largesse). Moreover, being charitable was a duty and obligation of all Christians who would be rewarded in the next life if not in this. To the extent that charity was a public activity—and it was since those who gave wanted to be sure that their generosity was recognized and rewarded—it could be monitored. As in *Caritas in Veritate* eschatological rewards and the awareness of the transcendent were central features of this society. As countries developed, the universal power and wealth of the Church diminished or became fractured and cities grew. Civic duty replaced religious charity as the source of poor relief. Compulsion (taxation) replaced voluntary (if incentivized) cooperation and social cohesion weakened.<sup>20</sup>

### *The Business Firm and its Stakeholders*

A firm, like any other group, forms a type of society with its own cultural ethos. Those who work for, or own, the firm do so freely. They also agree, implicitly or explicitly, on the overall goal that is pursued and on how its resources are divided. The goal of a firm is usually stated as the maximization of profits, which means maximizing the difference between revenues and costs. Profit maximization is much condemned as a goal, and it is often suggested that, in the pursuit of profits, exploitation of inputs to production (such as workers or the natural environment) is accepted by economists as good practice.<sup>21</sup> It is not, and it occurs only when firms do not have to pay for the costs that their production decisions impose on individuals, the environment, or the economy as a result of a market failure. Economists recognize and identify these situations and suggest mechanisms, economic, legal, or social, to minimize or eliminate them. Also, in stating the goal of a firm to be profit maximization, the individual motivations of the owners and managers of the firm are obscured. What motivates them, no doubt, is to care for their families and, perhaps, a broader community, which includes all the stakeholders of the firm, to the degree that they are able.<sup>22</sup> These motives can be achieved by seeking to maximize profits, since profitable firms can offer secure employment which benefits both its employees and the communities in which they live. They can offer, further, consistent demand for other inputs to production from its suppliers, which benefits its supplier's employees and the communities in which they live and can offer its stockholders a good return on their investment. Thus, profit maximization can be considered a socio-economic goal, when the society in question is the firm itself or the firm and its stakeholders, which include its

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20 See deSwaan, *In Care of the State: Health Care, Education and Welfare in Europe and the USA in the Modern Era*; Burton Abrams and Mark Schitz, 'The 'Crowding-Out' Effect of Governmental Transfers on Private Charitable Contributions,' *Public Choice* 33 (1978): 29–39.

21 *Caritas in Veritate*, 21 and 40.

22 *Ibid.*, 38.



stockholders. *Caritas in Veritate*, however, expresses the contrary view.<sup>23</sup> Furthermore, if a firm is not profitable it cannot remain in business without being subsidized.<sup>24</sup> Unless these subsidies are driven by market failures, they will generate additional distortions at a cost to individuals and the wider economic and social community.

How does a firm maximize profits? I will examine this firstly in the abstract, then in the context of the real world. In the most abstract case, perfectly competitive firms take both the prices of the goods they produce and the inputs into production as given and hire labour and capital (their inputs) to maximize their profits. They produce at the level where their marginal revenues equal their marginal costs and they earn zero profits. If, in this scenario, the firm were to pay its workers more, say a just wage, it would go out of business. If it were to charge more than the market price, say, a fair price, so that it could pay a just wage, it would sell nothing as its customers would buy from its competitors.<sup>25</sup> If it were to choose only to pay the owners of capital what it determined was a just rental rate (the price of capital) so that it could pay a just wage (taking into account the primacy of labour over capital following Catholic Social thought) and were this lower than the market rental rate, no capital would be made available to it and so nothing could be produced.<sup>26</sup>

Now consider a firm which is a large employer in an imperfectly competitive market. It employs highly skilled workers (whose skills are in high demand elsewhere in the economy) as well as relatively unskilled workers with few alternative employment options. The firm procures inputs from a wide range of specialist suppliers for whom the firm's orders represent a significant proportion of their businesses. The firm is one of many firms producing similar goods in the world market. The product the firm supplies has an international customer base. These customers can choose to continue purchasing the firm's goods or they can take their custom elsewhere. The firm recognizes that while pay is important to workers, other non-pay benefits, such as child care provision, flexible work hours, subsidized travel, sick leave, support for continuing education, support for community activities, and encouragement and reward for improving the way the firm does business, etc., are also important.<sup>27</sup> The firm offers its employees a good environment in which to work, and the employees respond by working harder and, because they have high job satisfaction, more productively.<sup>28</sup> The firm may also provide job

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23 Ibid., 40.

24 While micro-finance is promoted in *Caritas in Veritate*, the reality is that most of this lending does not lead to improved well-being and most microfinance lenders make losses (see *Caritas in Veritate*, 45, 65; Dean Karlan and Jonathan Zinman, 'Expanding Microenterprise Credit Access: Using Randomized Supply Decisions to Estimate the Impacts in Manila,' Yale University Working Paper [2009]).

25 *Caritas in Veritate*, 63, 66.

26 In a perfectly competitive market another firm would enter and pay the market determined wage and the market determined rental rate on capital and make zero profits. It would not, however, be able to attain any social goals.

27 Google is probably the firm that provides the widest array of non-wage benefits to its employees (see <http://www.google.com/corporate/culture.html> [accessed December 7, 2010]).

28 George Akerlof, 'Labor Contracts as Partial Gift Exchange,' *Quarterly Journal of Economics* 97 (1982): 543–569.

guarantees in economic downturns, or, at least, attempt to maintain a majority of its workforce even though they are underemployed during the downturn and the firm must absorb losses. It chooses to do this because it has invested in its employees and they are more valuable to it than new employees would be, and because this is part of the implicit contract it has with its employees which motivates them to be more productive.<sup>29</sup> The firm has also an ongoing relationship with its suppliers of both goods and services. Its suppliers may be located close to the firm or may be located on the other side of the globe. The suppliers could have originally been part of the firm or may provide a service that had been previously done in-house. It prefers its goods suppliers to other potential suppliers and so does not put each new part or equipment order out to tender. This ensures its suppliers a steady core business. They respond by preferring this client and providing the goods ordered on time and made to the exact specifications. The inputs, so supplied, may be more expensive, but this cost is saved both in down time (when parts are not available) and in defective output (as a result of inferior parts). It prefers its service suppliers to other potential suppliers since they have an intimate knowledge of a particular aspect of its business while also having expertise, via specialization, which was unachievable in house. The firm must nurture and maintain this relationship even if the supplier operates from abroad. A firm's local community is no longer defined narrowly. Again, the firm is able to access a higher quality of service, which enables it to be technically more efficient in its productive activities. The firm also provides a warranty on all goods it produces under which it promises to repair or replace any of its goods found deficient for whatever reason.<sup>30</sup> This warranty signals to its customers that it is providing them with a quality product which builds customer loyalty and induces repeat purchases and word of mouth advertising. These behaviours by the firm can be interpreted as arising from the firm's owners placing the interests of its stakeholders, its workers, suppliers and customers, above its stockholders.<sup>31</sup> However, these behaviours all lead to higher economic profits, which stockholders demand, and higher welfare for the firm's stakeholders than in their next best alternative.

### *The Community of Nations: Doha and Copenhagen*

Now let us consider the community of nations when it comes together to improve the economic welfare of all members of that community.<sup>32</sup> Such a situation exists in the ongoing world trade negotiations. For these negotiations to be successful, everyone must agree on the socio-economic goals. This agreement has not been found in the current Doha round of the World Trade Organization talks which began in 2001 and still

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29 Costas Azariadis, 'Implicit Contracts and Underemployment Equilibria,' *Journal of Political Economy* 83 (1975): 1183–1202.

30 Sanford J. Grossman, 'The Information Role of Warranties and Private Disclosure about Product Quality,' *Journal of Law and Economics* 24 (1981): 461–483.

31 In *Caritas in Veritate* it is suggested that firms put the interests of their shareholders above the interests of their stakeholders to the cost of those stakeholders. This, clearly, need not be the case (see *Caritas in Veritate*, 40).

32 *Caritas in Veritate*, 58 and 66.

continue. The problem is that the countries involved do not share the same vision, do not trust each other, find the process to be insufficient for its aims, and find the definition of development to be too narrow. They do not fundamentally agree on what constitutes the common good.<sup>33</sup> The issues revolve around, for example, agricultural tariffs and other agricultural policies (such as rich world subsidization of agriculture and market access). The questions are who will gain and who will lose and by how much. These discussions and disagreements would take place even if all agreed that by reducing tariff barriers and eliminating agricultural subsidies (by rich countries) more would be produced and the prices for consumers would fall since the manner in which the gains would be distributed could still leave some in the developed world worse off both economically and culturally (developed world farmers, for example, could no longer engage in farming leading to the demise of the farming culture).

Compensating farmers for their losses is a difficult issue to resolve. The problem here is that even if there is global gain there may be local losses. From the outside, it is easy to concentrate on the positive net gains (the benefits to the developing country farmers and developed country consumers mentioned in *Caritas in Veritate*) rather than the underlying losses (the costs to developed country farmers are not mentioned in *Caritas in Veritate*), but the individual governments involved, whose societies as well as economies, or sectors thereof, stand to lose, have to convince their people that the loss is acceptable, which is easier said than done.<sup>34</sup> Further, the redistributions from poor to rich which were discussed in the simple model are not here politically feasible even if they would lead to a preferred outcome.

Similar disagreements arose at the recent Copenhagen Climate Change Summit where developed and developing countries could not agree on the process the negotiations should take, what the concrete goals should be, or how they should be implemented.<sup>35</sup> Agreement over what constituted the common good, in practice (reducing carbon emissions which would likely require a reduction in economic activity by the poor as well as the rich) rather than in theory (saving the Earth for current and future generations, consistent with the message of *Caritas in Veritate*) could not be reached.<sup>36</sup> Further, there was no agreement on what resources were available to achieve what some deemed to be the minimum goal of arresting climate change. The funds some declared to be essential were more than the rich countries were willing, or able, to dedicate, given the short and long run needs of the residents of those countries. Goals were necessarily redefined, but common purpose was not found.

It can be inferred that part of the reason behind the failures of the Doha Round and the Copenhagen Summit is that all participants could not agree on a definition of the common good and were not convinced that they would not be worse off were they to

33 David Harvey, 'What Prospects for a Doha Round Agreement on Agriculture?' *EuroChoices* 6 (2007): 48.

34 *Caritas in Veritate*, 58.

35 Gobierno Bolivariano de Venezuela 'Declaración política del ALBA en Copenhague,' 18 December 2009, [http://www.minci.gob.ve/noticias\\_-\\_prensa/28/194547/declaracion\\_politica\\_del.html](http://www.minci.gob.ve/noticias_-_prensa/28/194547/declaracion_politica_del.html) (accessed December 7, 2010).

36 *Caritas in Veritate*, 48, 50, and 51.

agree to any of the plans that were on offer. Thus, freer world trade or a better world environment—which, it is argued, would benefit all and, so, could be considered as constituent of the common good—are not worth the costs imposed on the individual countries that together are required to achieve them. The benefits are economic, political, and social, as are the costs. Benefits exceeding costs globally matters little if the local calculus does not reflect that net benefit. The failure of these global negotiations can be equated to the rich redefining society to exclude the poor, or vice versa.

### *Market Dynamics*

An issue that is evident in the examples of the firm, the Doha Round, and the Copenhagen Summit is that of the costs born by individuals or groups in rich and poor countries alike, when markets adjust in response to, among other things, changes in demand as a result of changes in consumer tastes, changes in tax structures (such as the tariffs on and subsidies for agricultural products), changes in technology, or an economic downturn. When the economy responds to changes in demand—such as the shift in demand from horse drawn carriages to motor cars—some industries shrink and eventually cease to exist while other industries come into existence and grow. These changes require a redeployment of capital and labour from the shrinking industries to the growing industries. That these redeployments are necessary is signalled in the market by falling profits, reduced returns on capital invested and lower wages in the shrinking industries. They are also signalled by rising profits, higher returns on capital invested and higher wages in the growing industries. While financial capital can move quickly between shrinking and growing industries as it is redeployed to its highest return use (which implies an efficiently operating financial system), some physical capital (plant and equipment) will become obsolete and will lose all its value causing the owners thereof to suffer a reduction in the value of their wealth. Some human capital (skills embodied in workers) will also become obsolete, thereby reducing the wage the owner of that human capital can command. In contrast, some physical capital will become more valuable as will some human capital. Thus, some lose and others gain. These losses and gains are called pecuniary externalities. When these adjustments occur the possibility of redistributing some of the gain to those who have seen their income fall to ensure that they are able to meet their basic needs and, perhaps also, to participate fully in society are common. These take the form of unemployment benefits, trade adjustment benefits, or social welfare payments (although, in reality, these are often inadequate to the task).

When the losers and the gainers are in different countries, the issues are more fraught, especially as the gainers may be significantly poorer than the losers. This can be seen when a firm in a developed country moves from in-sourcing a part or a service, either by producing it itself or by buying it locally, to outsourcing that part or service to a foreign firm. The firm takes this decision to increase its profitability (please remember that such a decision would not be taken if it led to a severe reduction in morale and productivity), but, as a result, some domestic workers may lose while some foreign workers gain.<sup>37</sup>

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37 Richard Freeman, 'The Future U.S. Labor Supply: Shortages, Surpluses, or What?' in *Global Imbalances: As Giants Evolve*, ed. Jane Sneddon Little (Boston, MA: Federal Reserve Bank of Boston, 2008).

Although the net gains are positive, redistribution of those gains is not straightforward. The issue is almost identical in terms of the trade talks. Removal of agricultural tariffs and subsidies, both of which are barriers to free trade, will increase economic efficiency by revealing much developing world agriculture to be relatively more productive and less costly even taking into account the developing world's poor infrastructure. Farmers in the developed world lose, farmers in the developing world gain as investment moves from developed to developing world agriculture. International redistributions should not be necessary given that the tariffs and subsidies had created distortions and inefficiencies in the market, which had benefited developed world farmers while imposing costs on developing world farmers. However, developed country farmers still would feel aggrieved as a result of the (potential) loss of their income and their way of life, their culture, while developing country farmers feel aggrieved at the past and future years of potential gains that are denied them. That said, the trade negotiations and the potential gains they promise are driven by freeing up the market, but not without a cost to some.

An economic downturn, a recession, also redeploys capital and labour. Again, individuals suffer from the pecuniary externalities that result from markets adjusting to the current market conditions. In most developed countries social welfare programs cushion the loss. Poorer countries may not have the ability (as a result of insufficient tax revenues and their inability to borrow on world markets at an acceptable cost) to do the same. Attempts to do so could mire the country in debt, default on which would reduce its future ability to borrow at reasonable rates, if at all. Large overhangs of sovereign debt, whatever their source, and other forms of fiscal profligacy can require draconian measures in order to return a country to fiscal probity. The immediate human cost of these adjustments can be high as can the short and longer term cost of delaying the needed adjustments into the future. This has led to discussions of responsibility for individuals' welfare beyond the bounds of nation states.<sup>38</sup> This can be justified given the extent of global economic integration and the fact that many, although not all, developing countries are small and, to some degree, open economies in which export revenues make up a large percentage of GDP. Because of their openness and smallness, recessions in the developed world can lead to more severe recessions in parts of the developing world since developed country demand for developing country exports falls. This being the case, should developed countries provide developing countries with the wherewithal to meet the basic needs of their people for the duration of the recession or even more generally?<sup>39</sup> As in the case of the rich and poor, above, this depends on the costs and benefits in a situation in which total available funds may not be sufficient to meet everyone's needs. Budget constraints are binding on all. It is further complicated by the absence of an agreed extent of responsibility (who pays what to whom through which mediating body, the World Bank, the IMF, or the UN?), of dynamic incentive problems (why should a country provide for its own people if others will do it, or why should a country not be

38 *Caritas in Veritate*, 33.

39 For a more complete discussion and references to this debate, see David Crocker, 'Globalization and Human Development: Ethical Approaches,' in *Globalization Ethical and Institutional Concerns*, ed. Louis Sabourin et al. (Vatican: Pontificiae Academiae Scientiarum Socialium, 2001), 45–72.

profligate if its debts are always forgiven?), and of benefits for the developed countries being delayed until well into the future, when the current governments, which provide the funds, will no longer be in power.<sup>40</sup> To complicate matters further, the benefits of such generosity are impossible to attribute since net gains cannot be computed.

## Finance

A last issue I will address, but not the last issue in the discussion or the debate, is the potential for finance and financial markets to destabilize real economies.<sup>41</sup> Such destabilization can lead to changes in the distribution of income and wealth, both within a country and internationally, and can lead to neither basic needs being met nor that which is required to fully participate being readily available to all. Before considering the effects of financial markets, it is best to consider their role in the economy.

Financial markets bring together those who wish to delay consumption into the future, the savers, with those who wish to bring future consumption into the present, the borrowers. The markets allocate capital to the highest return uses so that all investments with risk adjusted returns above the market interest rate will receive finance. Investments yield employment to both labour and physical capital, and the return to that employment is both consumption today and saving for consumption in the future which funds additional investments. The lower the market interest rate, the greater is the number of profitable investments, and the higher are employment, consumption, and saving. The determination of whether or not an investment should be funded depends on whether or not the risk adjusted return over the life of the investment is high enough given the current and expected future market interest rates.

Since investments in developing countries are often very risky, as a result of poor physical infrastructure, inadequately trained workers, poorly defined property rights, high levels of corruption, poor judicial systems, poor protections for workers, etc., the lower the market interest rate, the more investment projects in developing countries will be funded. Thus, in the decade prior to the current financial crisis when world interest rates were low and world market liquidity was high, funds flowed into developing countries to finance investment projects. Few words of caution were raised or listened to during this expansionary period. Things, by and large, were good. Problems were only recognized when the financial crisis hit, and market interest rates rose as liquidity dried up. Funding for investments dropped precipitously in the developed and developing world alike. To the extent that developing countries are more reliant on world, rather than domestic, financial markets and on markets rather than aid, and to the extent that most investments therein are highly risky, developing countries stand to be inordinately affected by financial market fluctuations. The question is whether international financial markets and their domestic and international regulators and the domestic and international market places they inhabit are culpable for the problems caused and, if they are, what responsibility do they have and to whom. The issues now should be very familiar as will be the solutions thereto.

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40 *Caritas in Veritate*, 67.

41 *Ibid.*, 65.

## Conclusion

I now return to the questions I raised at the outset: can socio-economic policy provide the *economic requirements*, both in terms of goods and economic opportunities, necessary for authentic human development? Can this be achieved without explicitly considering transcendence as a motive for the socio-economic policies? The answer to both questions is yes, but, as I have suggested, the practical hurdles are huge. In moving from what can be to what is, the issues are many and fundamental. However, they can be reduced to the fundamental economic constraints of the scarcity of resources and unavoidable redistributions caused by market dynamics, the fundamental political constraints of preference for one's own citizens over others and election cycle planning horizons, and the fundamental social constraint of the failure to agree on what constitutes the common good. The quest for authentic human development is frustrated by the failure to agree that authentic human development is the common good, what all members of society agree that we are striving for, and what informs all aspects of our society, socially, politically, economically, and judicially. It is here that the voice of the Church has hardly been heard, but must be heard, if *Caritas in Veritate* is to be more than an unanswered cry in the wilderness.

## Author Biography

Rowena Pecchenino, Professor of Economics and Dean of the Faculty of Social Sciences at the National University of Ireland, Maynooth, has published in the fields of macroeconomics, banking, growth, defence, environmental, health economics, and the economics of religion. Her work has appeared, for example, in *American Economic Review*, *Economic Journal*, and *Journal of Public Economics*. Her current research examines behavioural economics and the connection between economics and theology.