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Ethics in Economics: Lessons and Themes for Further Development from *Oeconomicae et pecuniariae quaestiones*

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The 2018 Vatican document Oeconomicae et pecuniariae quaestiones: *Considerations for an Ethical Discernment regarding Some Aspects of the Present Economic-Financial System* examines the relationship between ethics and economics in the context of contemporary issues in finance.[1] It contributes to reflection that has been taking place since the financial crisis. It also continues the development of Catholic social teaching and thought in this area. For example, the document builds on the papal encyclicals *Caritas in veritate*,[2]

[1] Congregation for the Doctrine of the Faith and Dicastery for Promoting Human Development, Oeconomicae et pecuniariae quaestiones*: Considerations for an Ethical Discernment regarding Some Aspects of the Present Economic-Financial System*, Vatican website, May 17, 2018, https://press.vatican.va/content/salastampa/en/bollettino/pubblico/2018/05/17/180517a.html (hereafter cited in text as *OPQ*).
[2] Benedict XVI, *Caritas in veritate*, encyclical, Vatican website, June 29, 2009, http://www.vatican.va/content/benedict-xvi/en/encyclicals/documents/hf_ben-xvi_enc_20090629_caritas-in-veritate.html, § 36 (hereafter cited in text as *CV*).

Rerum novarum,[3] *Quadragesimo anno*,[4] and *Centesimus annus*;[5] the Pontifical Council for Justice and Peace's *Compendium of the Social Doctrine of the Church*;[6] the work of the late Scholastics;[7] and St. Thomas Aquinas.

The relationship between ethics, business, finance, and economic life in general is a major theme of the document. It states, for example, that ethical practice must begin with a personal choice between right and wrong. "It must be noted that the systems that give life to the markets … are in fact founded on relationships that involve the freedom of individual human beings. It is evident therefore that the economy, like every other sphere of human action, 'needs ethics in order to function correctly—not any ethics whatsoever, but an ethics which is people-centred'" (*OPQ*, § 8). The document further notes that freedom ought to be oriented toward the good and the true if the common good is to be promoted (see § 23). Importantly, it points out that economic activity has a relational character; it is not just about goods and services being exchanged (see especially §§ 8–11). This point provides a further justification for not separating economics from ethics.

Despite references to the importance of ethics and education, it is notable that the treatment of virtue ethics in *OPQ* is limited. Furthermore, it raises a series of issues that we should see through a different light when we accept the importance of the virtues. A full and explicit consideration of the practice of the virtues would have helped to unify various aspects of the message and provided a solid basis for thinking about the design of programs of education that might change culture.

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[3] Leo XIII, *Rerum novarum*, encyclical, Vatican website, May 15, 1891, http://www.vatican.va/content/leo-xiii/en/encyclicals/documents/hf_l-xiii_enc_15051891_rerum-novarum.html (hereafter cited as *RN*).
[4] Pius XI, *Quadragesimo anno*, encyclical, Vatican website, May 15, 1931, http://www.vatican.va/content/pius-xi/en/encyclicals/documents/hf_p-xi_enc_19310515_quadragesimo-anno.html (hereafter cited as *QA*).
[5] John Paul II, *Centesimus annus*, encyclical, Vatican website, May 1, 1991, http://www.vatican.va/content/john-paul-ii/en/encyclicals/documents/hf_jp-ii_enc_01051991_centesimus-annus.html (hereafter cited as *CA*).
[6] Pontifical Council for Justice and Peace, *Compendium of the Social Doctrine of the Church* (London: Burns & Oates, 2005), especially §§ 270–374.
[7] André A. Alves and José M. Moreira, *The Salamanca School* (New York: Bloomsbury Academic, 2013).

This paper explores these themes in greater depth. Taking the Vatican document as the starting point for dialogue rather than as the last word, I begin by exploring the importance of the practice of ethics and the virtues in economic life. If one sees the virtues as important, the dynamic of debates about practice within financial markets, education, culture, and regulation changes. Next, I examine some of the particular practices in financial markets that are discussed in *OPQ*. I reach conclusions different from those in the document about the appropriateness of those practices, for we can see them in another context if we consider the potential to improve rather than just restrain and prohibit behaviors. This discussion then leads to observations about education and culture. Finally, the paper takes up the issue of regulation, in particular, how a Christian anthropology of the human person can help us understand the limits of regulation, as well as the diverse sources of different forms of regulation.

The Vatican document states at the beginning: "A synthesis of technical knowledge and human wisdom is essential. Without such a synthesis, every human activity tends to deteriorate. But where it exists, it can foster progress towards the integral and concrete well-being of the human person" (*OPQ*, § 1). To use academic terms, one can say that an interdisciplinary approach is necessary when thinking about how financial markets can operate for the common good and how people should operate within them. This paper takes an interdisciplinary approach by combining an analysis of the importance of the virtues with the need for professional competence and an understanding of a proper Christian anthropology of the human person. This approach underlies the analysis of political economy. These insights help to unify the different topics discussed in *OPQ* and situate it more clearly within the tradition of Catholic social teaching and the role of the state that is posited in that teaching.

Ethics and Virtue in Economic Life

It is widely perceived that Catholic social teaching in general and the current pope in particular are hostile to business and finance.[8] This perception is false. CST tends to welcome business and finance while highlighting the need for ethical behavior in economic life so that business serves society. The need for ethics in economic life was put succinctly by Pope Benedict XVI: "Economy and finance, as instruments, can be used badly when those at the helm are motivated by purely selfish ends. Instruments that are good in themselves can thereby be transformed into harmful ones. But it is man's darkened reason that produces these consequences, not the instrument *per se*. Therefore it is not the instrument that must be called to account, but individuals, their moral conscience and their personal and social responsibility" (*CV*, § 36).

Many schools of economics have tended to separate economics teaching from ethics. For example, Keynesian schools have encouraged a focus on aggregate variables rather than on personal action (although this tendency was not true of Keynes himself). The Chicago school has tended to narrow the focus of economics to nonethical questions; it has pioneered the study of crime, the family, and so on, but it has done so through an empirical lens. An aspect of this tendency has been the trend for economic modeling to become more abstract and mathematical.[9] However, Lord Robbins, who was one of the greatest historians of economic thought of the twentieth century, *did* stress that economics involves the study of human behavior. Specifically, Robbins defined economics as "the science which studies human behavior as a relationship between ends and scarce means which have alternative

[8] With regard to CST in general see, for example, Thomas E. Woods Jr., *The Church and the Market: A Catholic Defense of the Free Economy* (Lanham, MD: Lexington Books, 2005), 1; and Peter Bauer, "Ecclesiastical Economics: Envy Legitimized," in *From Subsistence to Exchange and Other Essays* (Princeton, NJ: Princeton University Press, 2000), 94–108. For one example of criticism of comments Pope Francis has made about market economies see: https://www.telegraph.co.uk/finance/economics/10906849/The-Popes-attack-on-capitalism-shows-he-knows-nothing-about-how-the-world-really-works.html

[9] This trend has been criticized by many, including the Post-Crash Economics Society at the University of Manchester, which has had the support of a number of prominent economists.

uses."[10] This definition, which is widely used in high school and undergraduate economics courses, immediately raises questions about ethics.[11]

At a basic level, we can say that, whenever "human" and "action" or "behavior" appear in the same sentence, ethics is likely to be important. As Benedict puts it, "*Every economic decision has a moral consequence*" *(CV*, § 37). If we attempt to teach economics without ethics, we would be limited to teaching technique and thus, perhaps, would ignore highly significant aspects of economic action. One such aspect is the choice of ends. For example, business owners may choose between maximizing owner value measured in financial terms often with reference to share price without taking into account any other considerations (such as how vulnerable members of the workforce are treated), or they may choose to pursue a broader set of ends. This is a decision about chosen ends, and ethics has something to say about it.[12]

The choice of means should also involve ethical discernment. For example, a particular business may have a perfectly satisfactory chosen set of ends, such as making a profit while treating its employees justly, but the means it chooses to meet those ends, such as selling pornography, are morally problematic. Another business with the same ends may choose to meet them by selling alcohol or operating in the financial sector. These latter activities are not intrinsically immoral, but they could be in certain circumstances (for example, if the marketing of alcoholic products were aimed at young people who were known to have a weakness for drinks packaged in particular ways).

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[10] Lionel Robbins, *An Essay on the Nature and Significance of Economic Science* (London: Macmillan, 1932).

[11] For an excellent discussion of economic technique and its relationship with ethical reasoning, see Andrew Yuengert, *The Boundaries of Technique: Ordering Positive and Normative Concerns in Economic Research* (Lanham, MD: Lexington Books, 2004).

[12] It should be noted that (and, again, Yuengert is excellent on this point) it is necessary to follow through this reasoning to consider ultimate ends and ultimate decision-makers. For example, money is rarely an end in itself (except in the case of a miser); it is the goods that are bought that are ends. At the same time, the business owners might maximize financial owner value to give away the money to development projects; thus, the owners might not be maximizing the financial value of the business for their own ends.

Further ethical dimensions are revealed when we consider the *intent* of actions in the economic sphere. To take a specific example to which the Vatican document refers, if one intends to provide cheaper mortgages for families by creating complex securitization products in financial markets, the intent would not seem to be morally problematic, even if some people did not understand the product and, as a result, incurred some minor financial loss.[13] If, instead, one's intent is to create a product that others do not understand and thereby make money from selling it, knowing that large numbers of people would suffer losses, it would be morally problematic. As the document states, "What is morally unacceptable is not simply to profit, but rather to avail oneself of an inequality for one's own advantage, in order to create enormous profits that are damaging to others" (*OPQ*, § 17). The words "in order to" imply an intent to make profits at the expense of others.

These basic ethical questions having to do with ends, means, and intent in economic life should not be ignored by those operating in the business sector. In some cases, there are not straightforward answers to questions relating to ethics in economic life, and the integration of technical knowledge and human wisdom is necessary when making judgments, as is noted in the first paragraph of *OPQ*. Economists do not entirely ignore ethical issues, but they tend to treat them in an empirical rather than in a normative framework.[14] Such an approach might be regarded as a reasonable division of labor between the economist and the ethicist, though Yuengert questions this approach.[15]

One example of an economist who considers the practical effects of ethics is Nobel Prize winner Kenneth Arrow, who said, "Virtually every commercial transaction has within itself an element of trust. …It can be plausibly argued that much of the economic

[13] I have described a situation wherein the intention is good and there are some unfortunate by-products of the action. The intention might be good, but the outcome terrible: in such a case, acting with prudence should make people think twice before marketing such a product.
[14] In addition to Yuengert, an excellent reference on this subject is Mary L. Hirschfeld, *Aquinas and the Market: Toward a Humane Economy* (Cambridge, MA: Harvard University Press, 2018).
[15] Yuengert, *Boundaries of Technique*.

backwardness in the world can be explained by the lack of mutual confidence."[16] Interestingly, Benedict XVI, considering the problem from the perspective of a theologian, made a remarkably similar comment: "*Without internal forms of solidarity and mutual trust, the market cannot completely fulfil its proper economic function*" (*CV*, § 35). This juxtaposition highlights the importance of an interdisciplinary approach to education. Ethical discernment can make use of empirical observation. At the same time, it is important in the context of Christian education to have a stronger basis for making ethical judgments than simply an understanding of empirical consequences of actions.

In the Catholic tradition, this formational aspect of developing the ethical person is often rooted in a nurturing of the virtues. It is puzzling that there is no reference to virtues *OPQ*, given that the practice of the virtues is a crucial aspect of promoting ethical choices in the economy in general and in financial markets in particular. The Vatican document contrasts with *RN*, in which the word *virtue* appears fifteen times, and also with the interventions after the financial crisis of Cardinal Vincent Nichols, who frequently stressed the importance of practicing the virtues in finance and business life.[17] The relational aspect of economic activity immediately signals the need for the practice of virtues such as temperance.[18] If enacted, this virtue would lead people to behave in the economic sphere with restraint, humility, and modesty; to forgive and be careful not to retaliate and bear grudges; and not to believe that somebody else doing something wrong justifies their doing something wrong.

[16] Kenneth J. Arrow, "Gifts and Exchanges," *Philosophy & Public Affairs* 1, no. 4 (Summer 1972): 357.
[17] See, for example, Archbishop Vincent Nichols, introduction to *Christian Perspectives on the Financial Crash*, ed. Philip Booth (London: St. Pauls, 2010); and Bishops' Conference of England and Wales, *Choosing the Common Good* (Stoke-on-Trent, UK: Alive, 2010), which was published before the UK general election of that year.
[18] Courage and prudence also are needed, as will be discussed later, but these virtues may be more important in a different context.

Arrow's comment on trust and economic outcomes has been mentioned above. It is worth noting that the mottoes of both the London Stock Exchange and the Baltic Exchange in the UK have been, for a long time, "My word is my bond." The specific virtue that is needed for trust to be paramount in dealings in financial markets is that of justice, which ensures that all obtain what is due to them.[19] If participants in financial markets act justly, then trust can be built. The importance of trust in financial markets is also illustrated by the fact that the word *credit* is derived from the Middle French, Old Italian, and Latin word for *trust*, as Cardinal Nichols noted in his post-crisis interventions. A focus on the importance of the virtues allows us to develop further three themes of *OPQ*, which are considered in the sections below.

Making Judgments about Particular Practices

The ability to choose between right and wrong behaviors and to practice the virtues in economic life so that we are able to act as better people allows us to think in a more nuanced way about particular practices in financial markets that might otherwise be dismissed (the point which Benedict XVI makes in *CV*, § 36, quoted above). Practices in finance have come under scrutiny from ethicists for centuries. Since the financial crisis, attacks on the financial sector and practices within it have intensified and have come from a variety of perspectives. In the last ten years, there have been many examples of sustained criticism of the financial sector from academia, professional life, and different religious groups. For example, Lord Turner, chairman from 2008 to 2013 of the Financial Services Authority, which was then the UK financial regulator, claimed that much activity in the financial sector was "socially

[19] "What is due to them" does not simply mean what is their due according to written contracts; it also can relate to verbal agreements and implicit agreements (i.e., what two parties really expect when they enter into contracts).

useless."[20] Lord Turner, in the Turner Report, published in 2009 following the financial crisis, mentioned a number of the concerns also raised in *OPQ*.[21]

One of the reasons why the financial sector comes under attack is that its products are not tangible and, therefore, it is difficult to understand the purposes of financial institutions. This confusion is unfortunate, for the financial sector makes possible forms of economic activity that would not otherwise be possible. For example, without banks (or related institutions, such as money market mutual funds), all economic exchange would have to be facilitated through barter or a commodity money such as gold. The financial sector provides households with a secure place to save in a way that reduces risks and the costs of assessing potential borrowers while simultaneously ensuring that individuals and businesses can borrow to buy houses, finance business operations, and so on. Furthermore, the financial system allows businesses to borrow over a long time period, while households that save can access their capital instantly. If these functions were not performed efficiently, much real economic activity would be impossible. Perhaps it is not surprising that the Vatican document suggests that "here financial activity exhibits its primary vocation of service to the real economy: it is called to create value with morally licit means, and to favour a dispersion of capital for the purpose of producing a principled circulation of wealth" (*OPQ*, § 16).

However, the financial sector does not exist just to serve the real economy. Without a thriving financial sector, only the very wealthy or those who have strong family ties would be able to retire. The financial sector allows people to invest in a diversified range of companies, reducing the transaction costs of analyzing those companies for creditworthiness and their long-term ability to thrive, thus facilitating pensions saving and retirement. Without

[20] Turner, A. (2009) How to tame global finance. Prospect 162, 27 August 2009, https://www.prospectmagazine.co.uk/magazine/how-to-tameglobal-finance

[21] Financial Services Authority, *The Turner Review: A Regulatory Response to the Global Banking Crisis* (London: FSA, 2009). Common concerns in *Turner Review* and *OPQ* include securitization (chap. 1 and § 26, respectively), global regulation of financial markets (chap. 2 and § 21), and credit derivatives (chap. 2 and § 26).

insurance, people would live in fear of their homes being destroyed. Insurance companies pool risks, thus benefiting people on ordinary incomes who could not afford the financial catastrophe that arises from insurable events. Thus, the financial sector has intrinsic functions, not just instrumental ones.

The social usefulness of practices within financial markets is not always immediately apparent. Judgments about such activities require careful discernment. The Vatican document gives, critiques, and criticizes many examples of such activities. One such issue mentioned is high frequency trading (though with no elaboration); another is financial speculation. "Such a practice is particularly deplorable from the moral point of view when the intention of profit by a few through the risk of speculation even in important funds of investment, provokes artificial reduction of the prices of public debt securities, without regard to the negative impact or to the worsening of the economic situation of entire nations" (*OPQ*, § 17).

The practice of speculation has been widely discussed in the development of Catholic social thought. Baldwin, perhaps the most authoritative reference on speculation and moral theology in mediaeval times, argues that speculation, while it should not be illegal, is morally problematic.[22] Nakrosis examines objections to speculation in moral theology as discussed by Nell-Breuning.[23] Nakrosis concludes that speculation can have economically valuable effects and, in such cases, it should not be assumed to be morally wrong. Nell-Breuning himself did not come out firmly against speculation, but he did suggest that proximity to it could tempt people into sin. Johannes Messner's position is not dissimilar,[24] and the way the *Catechism of*

[22] John W. Baldwin, "The Medieval Theories of the Just Price: Romanists, Canonists, and Theologians in the Twelfth and Thirteenth Centuries," *Transactions of the American Philosophical Society* 49, no. 4 (1959): 1–92.
[23] Stephen Nakrosis, "The Ethics of Speculation in the Works of Oswald von Nell-Breuning," *Catholic Social Science Review* 18 (2013): 169–86. Nell-Breuning helped to write *QA*.
[24] Johannes Messner, *Social Ethics: Natural Law in the Western World* (St. Louis, MO: Herder & Herder, 1965).

the Catholic Church defines sinful speculation implies that there is such a thing as licit speculation.[25]

In fact, *OPQ* does not say that speculation is always and everywhere wrong, though it can be argued that the document leaves the reader with that impression. Proponents of speculation would argue that it has benefits. For example, in markets such as those for food, it can bring forward production of the physical commodity at times of shortage and, because it can provide liquidity in markets, can also reduce price fluctuations. Of course, there are critiques of speculation too, including within the academic economics literature. For example, Nobel Prize–winning economist Robert Shiller describes commonplace critical discussions of speculation in the US in the 1920s and 1930s.[26]

It would be reasonable, then, to say that the discussion of speculation and its relationship to virtue ethics could have been clearer in *OPQ*. This clarity could have been achieved by building on the inconclusive tradition of Catholic social thought. The question of intent, as well as the dangers of temptation to sin from the high profits that can arise from speculation, could have been emphasized. Such an approach would give us the tools to helps us understand when activities that may serve society in some circumstances are wrong in other circumstances.

The document also suggests that high interest rates being charged to borrowers is unethical *(OPQ*, § 16) and criticizes the use of offshore financial centers for the purposes of money laundering and tax evasion (§§ 30 and 31). In the former case, it is not suggested that interest should not be charged at all, and most modern interpretations of usury would not

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[25] *Catechism of the Catholic Church* (London: Geoffrey Chapman, 1994), § 2409 (hereafter cited in text as *CCC*). See also Samuel Gregg, *For God and Profit: How Banking and Finance Can Serve the Common Good* (Spring Valley, NY: Crossroads, 2016).
[26] Robert J. Shiller, "Narrative Economics," *American Economic Review* 107, no. 4 (April 2017): 967–1004. Interestingly, *OPQ* uses the phrase "irrational exuberance" (§ 21), which is widely believed to have been coined by Shiller.

argue that the charging of interest on loans should be prohibited.[27] The relative ethical merits of different forms of contract and different levels of interest rate, again, require discernment. As far as offshore financial centers are concerned, tax evasion and financial crime have long been regarded as illegitimate activities in Catholic social teaching. But the document does recognize the legitimate use of offshore finance. Once again, therefore ethical discernment is needed in judging such activity in particular cases.

Debt securitization also comes under scrutiny (*OPQ*, § 26) with the document especially criticizing their lack of transparency. This phenomenon has been widely discussed in a number of forums since the financial crisis. In the context of CST, for example, Cowley raised the issue in an early contribution by Catholic thinkers following the crisis.[28] Again, it cannot be said that securitization is intrinsically morally problematic. If the concern is complexity, there is no logical stopping point at which one can say, "This is too complex; it should be prohibited," or, indeed, "This is too complex; it is unethical." Central bankers and regulators, as well as people in financial markets, widely welcomed mortgage securitization, which is often blamed for the financial crisis. Indeed, Paul Tucker, the director in charge of financial stability at the Bank of England, speaking just before the crash, said, "So it would seem that there is a good deal to welcome in the greater dispersion of risk made possible by modern instruments, markets and institutions."[29] If the intention of those creating such securities was to lower funding costs for investors and help disperse risk (thus benefiting their own firms, households, and all those who relied on the stability of the banking system), then it is difficult to argue that their creation was immoral.

[27] See, e.g., Gregg, *For God and Profit*, chap. 3.
[28] Catherine Cowley, "How Financial Institutions Dug the Hole We're In," in *Christian Perspectives on the Financial Crash*, ed. Philip Booth (London: St. Pauls, 2010), pp 31-44.
[29] Paul Tucker, "A Perspective on Recent Monetary and Financial System Developments," speech at Merrill Lynch Conference, London, April 26, 2007, https://www.bis.org/review/r070508f.pdf .

A number of practices brought up in the document, including those mentioned above, are not in themselves objectively unethical, but they may have undesirable consequences in certain circumstances.[30] Such circumstances arise, of course, in many areas of human activity. The tone of the document is implicitly critical of the activities described and it is true that these areas of finance might provide occasion for sin and lead to temptation. However, it is reasonable to ask whether the document focuses on the activities to too great a degree rather than on practical advice and instruction about how to make ethical choices when faced with temptation in financial markets. Decisions in relation to such practices require the application of the virtues. In particular, temperance helps ensure that those in financial markets have the correct disposition when developing and marketing such products and practices. Justice is important for ensuring that both parties to a transaction are treated fairly and one side does not take unfair advantage of the other. Prudence is also required so that the impacts of behaviors and practices are clearly thought through. Of course, there will always be unforeseen consequences (see below); prudence will not lead to perfection. Nonetheless, a deeper discussion of virtue ethics might have led to such connections being made, allowing the document to make a distinct contribution to discussion about these questions. If we accept that particular activities in financial markets are not intrinsically wrong but may be so in certain circumstances, then the importance of education in the virtues becomes paramount, as does the question of culture. These are questions to which we turn in the next section.

Education, Culture, and the Virtues in Economic Life

Recognition of the many activities within financial markets that are not intrinsically unethical but that might be potential occasions of sin leads us back to the question of how we can make judgments in these situations. The importance of formation in the virtues arises

[30] "Undesirable" includes destabilizing the firm for which one is working or, indeed, destabilizing the whole financial system; consumers making poorly informed decisions; and a range of other outcomes.

again. Although some activities in financial markets may be regarded as intrinsically bad or of no social use, it is difficult to draw that line, and some activities may be problematic only in particular contexts. These factors call for the exercise of the virtues. According to a Thomistic way of thinking, the human person can judge matters of right and wrong through the employment of reason based on the primary precepts of natural law, which can be understood with great certainty. However, practical decision-making requires more nuanced ethical judgments, with the particular circumstances of time, place, and intent being important. This is not a matter of situation ethics or consequentialism. The ethical principles remain the same, but their application may lead to different actions in different contexts.

For example, the Vatican document explores the problem of what economists describe as information asymmetries, noting that certain financial transactions are not always unethical, but they may be so in particular circumstances where one party lacks relevant knowledge (see *OPQ*, § 14).[31] The document goes on to say (and here I expand upon a passage quoted above), "What is morally unacceptable is not simply to profit, but rather to avail oneself of an inequality for one's own advantage, in order to create enormous profits that are damaging to others; or to exploit one's dominant position in order to profit by unjustly disadvantaging others, or to make oneself rich through harming and disrupting the collective common good" (*OPQ*, § 17). Using the practical examples of horses and coinage, St. Thomas Aquinas dealt specifically with as the phenomenon of information asymmetries and how exploiting them may be unethical in some contexts and not others.[32] The late Scholastics also dealt with a number of examples.[33]

[31] One of the manifestations that this economic term describes is a situation in which a seller of a financial product has more information than the buyer, and thus, caveat emptor can be problematic.
[32] Thomas Aquinas, *Summa theologica*, trans. Fathers of the English Dominican Province, 2nd ed. (London: Burns, Oates, and Washbourne, 1920), II-II.77.2 and 3.
[33] See Alves and Moreira, *Salamanca School*.

Rules are not sufficient for ensuring that the common good is promoted in complex situations. The virtues of prudence (to help the buyer and seller understand the problem, including, crucially, what they do not know); justice (to ensure that the other party obtains what it is due); and courage (to fortify one in a situation wherein considerable pressure to behave inappropriately is being applied) are all necessary. Given the inability of regulatory and other external interventions to deal with the problem effectively (see below), the building of an ethical culture and the practice of the virtues through formation of participants in the financial system are necessary.

The necessary formation can come through education, both formal and informal. Here the Vatican document thrusts responsibility upon educational institutions, exhorting them as follows: "It is particularly desirable that institutions such as universities and *business schools* both foresee and provide … a formational dimension that educates the students to understand economics and finance in the light of a vision of the totality of the human person. … An ethics is needed to design such formation" (*OPQ*, § 10).

If we are to create the right culture according to Catholic social teaching, however, it is not just technical education or education in ethics in general that is important. Nor can the appropriate education start only in professional life. Formation must take place through a virtue ethics approach and start at the beginning of education. *The Catholic School on the Threshold of the Third Millennium* is highly critical of education that is reduced to technical aspects and that ignores ethical formation.[34] *Familiaris consortio* stresses the role of the family in education, especially in the virtues: "The family has vital and organic links with society, since it is its foundation and nourishes it continually through its role of service to life: it is from the family that citizens come to birth and it is within the family that they find

[34] Congregation for Catholic Education, *The Catholic School on the Threshold of the Third Millennium*, Vatican website, December 28, 1997, http://www.vatican.va/roman_curia/congregations/ccatheduc/documents/rc_con_ccatheduc_doc_27041998_school2000_en.html, esp. §§ 6 and 10.

the first school of the social virtues that are the animating principle of the existence and development of society itself."[35] The Second Vatican Council document *Gravissimum educationis* also emphasizes that "the family is the first school of the social virtues that every society needs."[36]

Therefore, from a Christian perspective, being formed in the virtues and in an ethical way of thinking through early education in the home and other places of education is a first step, and the process should continue through university and executive education. Although it is better, of course, if universities, professions, and companies themselves help educate and train individuals in the practice of the virtues applied to concrete situations in the world of finance and economics, this approach is likely to be more effective if education in, as well as the practice of, the virtues starts at a younger age. As the C*atechism of the Catholic Church* puts it: "Human virtues acquired by education, by deliberate acts and by a perseverance ever-renewed in repeated efforts are purified and elevated by divine grace" (§ 1810).

In financial markets, as noted above, the virtue of prudence, which "disposes practical reason to discern our true good in every circumstance and to choose the right means of achieving it" (*CCC*, § 1806), is especially important. There may be long chains of cause and effect between chosen means and desired or unintended ends and consequences. Operating with wisdom (see *OPQ*, § 1) and in a way that is well informed, especially about the impacts on those to whom we owe special duties, is also necessary. In addition, the virtue of courage is crucial. The amount of money tied up in the activities described and the challenges for businesses when changing course away from a particular business plan mean that it can be difficult to act in an appropriate, ethical manner either as an individual or as an entity—for

[35] John Paul II, *Familiaris consortio*, apostolic exhortation, Vatican website, November 22, 1981, http://www.vatican.va/content/john-paul-ii/en/apost_exhortations/documents/hf_jp-ii_exh_19811122_familiaris-consortio.html, § 42.
[36] Second Vatican Council, *Gravissimum educationis* [Declaration on Christian education], Vatican website, October 28, 1965, http://www.vatican.va/archive/hist_councils/ii_vatican_council/documents/vat-ii_decl_19651028_gravissimum-educationis_en.html, § 3.

example, in setting corporate strategies. In this context, "speaking truth to power," whistleblowing, and even resigning one's own position can be courageous acts of virtue in the face of temptation. Again, these are virtues that can be nurtured (or undermined) by culture and developed in higher education, continuing professional development, and other forms of education within the business sector. Because prudence requires careful reasoning in the full knowledge of the facts, education in the technical aspects of the activities described, their benefits, and their wider (perhaps problematic) impacts are necessary, as well as education in the virtues. It is appropriate that the document stresses an interdisciplinary approach.

The right kind of education can help promote an ethical culture in economic life in general and financial markets in particular. The creation of such a culture relies on education and formation, but it is also part of the wider social responsibilities of businesses.[37] The market can interact with the broader cultural sphere through professional associations and societies, unions, and a variety of other bodies.[38] But culture is important in economic life itself. The economic and cultural sectors are not separate, and the economy is not simply made up of atomized individuals whose decisions do not affect the decisions of others. Culture can influence how we behave. A degraded culture does not turn wrong actions into right actions, but it may make it harder to do what is good and reduce the culpability of those behaving unethically.[39]

The Vatican document does allude to this issue, pointing out that "every business creates an important network of relations and in its unique way represents a true intermediate social body with a proper culture and practices. Such culture and practices, while determining

[37] André Azevedo Alves, Philip Booth, and Barbara Fryzel, "Business Culture and Corporate Social Responsibility: An Analysis in the Light of Catholic Social Teaching with an Application to Whistle-Blowing," *Heythrop Journal* 60, no. 4 (2019): 600–13.
[38] See Rodger Charles, *Christian Social Witness and Teaching: The Catholic Tradition from Genesis to* Centesimus annus (Leominster: Gracewing, 1998), 392–94.
[39] See Alves, Booth, and Fryzel, "Business Culture."

the internal organization of the enterprise, influence also the social fabric in which it operates" (*OPQ*, § 23). Given that economic action is a subset of human action, the formation of culture and the impact of culture on decision making are important. Again, the education sector can assist with the development of an ethical business culture, not just by teaching about ethics and virtues in general, but by applying the ideas to realistic case studies to better prepare people for business life. This opportunity is available especially at the university level and in professional development.

Statutory Regulation: The Need to Develop the Political Economy Framework

Education and a culture more conducive to ethical behavior may help improve the functioning of the economic system in the service of the common good. However, such a program can never entirely overcome the problems of human imperfection. Given that human imperfection can destroy the effective functioning of financial markets, what should be the political-institutional response?

The Vatican document noted the following about the problem of imperfection within markets: "markets, as powerful propellers of the economy, are not capable of governing themselves. In fact, the markets know neither how to make the assumptions that allow their smooth running (social coexistence, honesty, trust, safety and security, laws, and so on) nor how to correct those effects and forces that are harmful to human society (inequality, asymmetries, environmental damage, social insecurity, and fraud)" (*OPQ*, § 13).

This language strangely anthropomorphizes markets. Markets operate within a human-created institutional structure and involve exchange between human persons in an extended economic order. Markets are not capable of "knowing" anything. However, individuals involved with market exchange are capable of knowing and controlling their behavior. "Markets" are not capable of choosing any more than a "farm" is capable of choosing whether to use cruel techniques to husband animals. Things can go wrong in markets because of human error and sinfulness, as noted in *CV* and discussed above. But human persons can choose another path, which is precisely why economics and ethics should be linked.

Given that markets can fail because people can fail, regulation by the state might be proposed to promote the common good. *CV,* for example, states that "regulation is made even more necessary in view of the fact that among the major reasons for the most recent economic crisis was the immoral behavior of agents in the financial world." This message is echoed in *OPQ*: "Regulation is made even more necessary in view of the fact that among the major reasons for the most recent economic crisis was the immoral behavior of agents in the financial world" (§ 21). There is a problem, however, with this line of reasoning. It may be the case that prudent consideration leads us to believe that government regulation can help promote the common good. However, to assume so automatically would appear to presuppose a degree of perfection among those making decisions related to regulation that cannot be found among market participants *or* among those making decisions in government regulatory bureaus.

As a result of human imperfection, regulation can be shaped by private interests rather than developed for the general public interest. Without using regulation as a specific example, Catholic social teaching has warned about the use of the political system to pursue private interests, and Pope Francis has warned about the relationship between business groups and the state.[40] The problem of regulation being shaped by private interests is one of the areas of research for which James Buchanan won the Nobel Prize in 1986, and it is explored in the discipline of public choice economics.[41] This area of economics is typically

[40] Pontifical Council for Justice and Peace, *Compendium*, §§ 565–74; Francis, *Laudato si'* (Vatican City: Vatican Press, 2015), § 197.
[41] See Dennis C. Mueller, *Public Choice III* (Cambridge, UK: Cambridge University Press, 2003), for a discussion of the discipline, although Buchanan's Nobel Prize lecture, "The Constitution of Economic Policy," is a useful and digestible source. "James M. Buchanan Jr. Prize Lecture," the Nobel Prize website, December 8, 1986, https://www.nobelprize.org/prizes/economic-sciences/1986/buchanan/lecture/.

associated with free-market economists, but Stiglitz and Marquand, who come from left-leaning perspectives, have also mentioned the problem of private interests shaping regulation.[42] These private interests include regulators themselves, politicians, and regulated industries that try to capture regulatory processes for their own benefit.

In addition, politicians and regulators may have cognitive biases that lead them to overestimate the efficacy of government regulation; they are not neutral arbiters. Furthermore, regulators may not be able to predict with confidence the impact of their actions, and regulation may even lead to the opposite of the intended effects. These so-called unintended consequences sometimes arise because of "second-round" effects, which are not obvious from a superficial analysis of the likely impact of regulation ("known unknowns"). Unintended consequences also may relate to factors that no reasonable, prudent analysis could have uncovered ("unknown unknowns"). Booth and Davies explain the unintended consequences of price controls, including interest rate controls, in financial markets.[43] Interestingly, in the seventeenth century, Locke wrote about interest-rate controls in financial markets in an example that is often cited as the origin of the idea of unintended consequences. It could be argued that the case St. Thomas Aquinas made for the toleration of prostitution was based, at least partly, on a concern for the unforeseen consequences of its prohibition.

In the case of the financial crisis, one does not have to go far to find interventions by government institutions that demonstrate this problem. For example, in the run-up to the financial crisis, regulatory moves encouraged banks to invest in mortgage-backed securities,

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[42] Joseph E. Stiglitz, *Freefall: Free Markets and the Sinking of the Global Economy* (London: Penguin Books, 2010); David Marquand, *Mammon's Kingdom: An Essay on Britain, Now* (London: Penguin Books, 2015).
[43] Philip Booth and Stephen Davies, "Price Ceilings in Financial Markets," in *Flaws and Ceilings: Price Controls and the Damage They Cause*, ed. Christopher Coyne and Rachel Coyne (London: Institute of Economic Affairs, 2015), 135–57.

actions that many believe were at the seat of the crash.[44] Mortgage-backed securities were also encouraged by government guarantees. As has been noted above, even just before the crash, a Bank of England senior official suggested that mortgage-backed securities would disperse risk in the financial system. The point here is not to excuse those who worked within banks in the 2000s and were responsible. The problem is that many of the actions taken by regulatory authorities and central banks either made the financial crash no less likely or made it more likely and its effects worse. Those who regulated banks share our human imperfection. This awareness should be the anthropological starting point for the analysis of statutory regulation as a solution to problems within financial markets.

These sections of the Vatican document on regulation justify *OPQ*'s call for an interdisciplinary approach to developing a genuinely deep understanding of economics—a theme that pervades the work of Hayek.[45] A combination of different strands of economics and political economy, along with an understanding of Christian anthropology of the human person and the practicalities of the financial system, is necessary if prudent and wise decisions are to be made about the role and limitations of statutory regulation. It can be argued that the consideration of economics alongside the nature of the human person comes through the work of Adam Smith, especially in *The Theory of Moral Sentiments* and *The Wealth of Nations* taken together.[46] Since the financial crisis, others have tried to revive this tradition,[47] but it is still largely absent from the study of modern economics and, despite the

[44] See, for example, Erik F. Gerding, "Bank Regulation and Securitization: How the Law Improved Transmission Lines between Real Estate and Banking Crises," *Georgia Law Review* 50, no. 1 (Fall 2015): 89-130.
[45] See Bruce Caldwell, *Hayek's Challenge: An Intellectual Biography of F. A. Hayek* (Chicago: University of Chicago Press, 2004), 339.
[46] Adam Smith, *The Theory of Moral Sentiments* (London, 1759); Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (London, 1776).
[47] See, for example, Luigino Bruni and Robert Sugden, "Reclaiming Virtue Ethics for Economics," *Journal of Economic Perspectives* 27, no. 4 (Fall 2013): 141–64; and Hirschfeld, *Aquinas and the Market*. Hirschfeld takes a distinctly Catholic approach, which, of course, Adam Smith did not.

message of the opening paragraph, is not obviously a theme of *OPQ*. Possibly as a result, the section relating to statutory regulation lacks subtlety and a distinctly Christian perspective.

It should be added that the virtues are needed in the area of regulation too. Prudence may help us understand unforeseen consequences or, at least, make us aware of their existence. Temperance and justice should help us not to seek or use regulatory powers to further our own interests. These fundamental human characteristics—the finitude of knowledge and the potential for selfishness to be exhibited in the political process—help us understand that there are limits to the efficacy of government regulation and that there is doubt about where those limits lie. Indeed, throughout its history, CST has criticized both an overbearing state and unbridled markets.[48] The principle of subsidiarity in CST can help us respond to these problems and, in particular, help us understand how a range of social institutions can restrain markets.

Subsidiarity in Financial Regulation

CST has long emphasized the importance of civil institutions in regulating the economy.[49] This emphasis is important given the potential shortcomings of government regulation in dealing with many of the problems that are perceived to exist in financial markets. Although *OPQ* (quoting an earlier Vatican document on the financial crisis) suggests that deregulation leads to a regulatory and institutional vacuum (§ 21), it goes on to say, in apparent contradiction, that "numerous associations emerging from civil society represent in this sense a reservoir of consciousness, and social responsibility, of which we cannot do without. Today as never before we are all called, as sentinels, to watch over genuine life and to make ourselves catalysts of a new social behavior, shaping our actions to

[48] See, in particular, *RN*; *CA*, §§ 1–22 (which also summarizes *RN* on this topic); and *QA*. Benedict XVI's *Deus caritas est* (encyclical, Vatican website, December 25, 2005, http://www.vatican.va/content/benedict-xvi/en/encyclicals/documents/hf_ben-xvi_enc_20051225_deus-caritas-est.html) has a short but direct reference to the dangers of an overbearing state, though it is in the context of addressing problems of poverty (see § 28).
[49] For example, see *CA,* § 48, in relation to regulation of human rights in the labor market and the development of the principle of subsidiarity in *QA*.

the search for the common good, and establishing it on the sound principles of solidarity and subsidiarity" (§ 34). The tradition of regulatory institutions developing within financial markets is otherwise neglected in the document.

There are numerous examples of such institutions regulating financial markets with great effect.[50] Perhaps the most notable example is that of stock exchanges. Until 1986 in the UK, and in earlier times in other countries, exchanges were entirely market-generated bodies that regulated markets strictly. The London Stock Exchange, like others, was essentially a club or society that could determine its own rules for membership and for the behavior of its members. Indeed, the regulation by the London Stock Exchange was so tight that the government curtailed its powers in 1986 because it believed the exchange had used its regulatory powers to effectively create a cartel.[51]

Stock exchanges are not the only examples of private, rule-making institutions in financial markets. Professional bodies blossomed in financial markets in the second half of the nineteenth century. Interestingly, their importance is mentioned in Catholic Church teaching in other contexts—for example, in documents such as *CA* and *QA*—but they were not mentioned in *OPQ*. In the US from 1875 to 1930, there was little regulation of accounting. Indeed, publicly quoted firms did not have to be audited, though many were. By 1926, 90 percent of companies quoted on the New York Stock Exchange had audited accounts, and, in many cases, there were professional bodies of accountants with their own rules who were responsible for auditing.

Such regulatory institutions are continually developing in new contexts. A modern example is the International Swaps and Derivatives Association, which, according to its mission statement, "fosters safe and efficient derivatives markets to facilitate effective risk

[50] See especially Edward Peter Stringham, *Private Governance: Creating Order in Economic and Social Life* (Oxford: Oxford University Press, 2015).
[51] See Philip Booth, "Stock Exchanges as Lighthouses," *Man and the Economy* 1, no. 2 (2014): 171–87.

management for all users of derivative products."[52] ISDA fulfills this mission in a number of ways, all of which involve regulatory functions, such as "developing standardized documentation globally to promote legal certainty and maximum risk reduction."[53] Members have to apply to join and can have their membership revoked.

Thus, it could be argued that the principle of subsidiarity and its application to regulation, especially that of market-based and civil society organizations, is another underexplored topic in the document. These institutions are can be especially significant because of their link with culture. Professional bodies, in particular, are educating bodies in their own right. They provide for their members an education not only in technical aspects but also in ethical conduct in professional life. By recognizing the potential role of civil institutions in the promotion of culture and the development of regulation, the Church would be applying the principle of subsidiarity in a field in which there is a rich historical tradition in practice, and it would be affirming, consistent with the social teaching tradition, that the promotion of the common good in this area is the responsibility of all institutions in society. Furthermore, it would be directly attacking and proposing solutions to the problem of the state-individual nexus, which pervades so much public policy debate and is incompatible with Catholic social teaching. "The exclusively binary model of market-plus-State is corrosive of society" (*CV*, § 39).

Conclusion

The 2018 Vatican document *OPQ* contains important reflections on ethical behavior in economic life, with particular emphasis on the financial system. In this respect, it reinforces and expands earlier teaching of the Catholic Church. Although many economists would argue that it is reasonable for them to examine technical or empirical economic

[52] "Mission Statement," ISDA website, https://www.isda.org//mission-statement.
[53] "Mission Statement."

questions without considering wider ethical issues, the relationship between economics and ethics cannot be ignored, given that economics involves the study of human behavior. As such, it is appropriate that the disciplines are unified, not just in Catholic social teaching but in academic research and teaching more generally. In economic life, persons have to choose ends and means, and such choices require ethical discernment, as *OPQ* stresses. However, the document does not stress the importance of the virtues, which, in Catholic social thought, should be regarded as the key to ethical decision-making in complex and challenging circumstances. Virtues such as courage, prudence, justice, and temperance need to be practiced if financial markets are to serve society effectively.

Deeper consideration of the virtues helps us understand the context in which particular practices in financial markets may or may not be unethical, or may or may not promote the common good. There has been significant discussion of these issues in the tradition of Catholic social thought. The Vatican document could have treated these questions of practice in financial markets more systematically had it contained a sustained discussion of the importance of the virtues in forming ethical behavior in financial markets.

The need to practice virtues in economic life also raises the question of education. Traditionally, the Catholic Church has held that the formation in the virtues should start at an early stage in life. Education from an early stage remains important if we are to build an ethical culture in financial markets. But the complexity of financial markets is such that university and professional development courses need to build on this foundation and combine the study of technical issues with discussion about ethics and the practice of the virtues. Effective education in business ethics based on the virtues can help promote an ethical culture, which, in itself, makes it easier for participants in financial markets to choose the good. Both culture and an education oriented toward the development of the virtues are underdeveloped themes in *OPQ*.

The document proposes various forms of regulation to promote the common good within financial markets, with the focus being on statutory or government regulation. Such regulation may be justified. However, an interdisciplinary approach combining insights from economics and political economy, along with a Catholic understanding of the nature of the human person, should help us appreciate the limits of statutory regulation in this field. Furthermore, a study of the history of financial markets, as well as of Catholic social teaching in other areas, may lead us to be predisposed toward regulatory institutions that arise within markets and civil society. This argument does not deny the need for state regulation, and the justification for statutory regulation of economic life in modern Catholic social teaching is certainly valid. However, other sources of regulation of markets are congruent with the principle of subsidiarity and the tradition of Catholic social teaching more generally.

Underscoring all the themes discussed in this article is the observation that our understanding of these issues changes as we focus on the importance of people striving for the good—rather than for the single goal of personal enrichment—when they are acting in the economic sphere. In relation to the regulatory framework for economic life, Cardinal Nichols wrote, "In place of virtue we have seen an expansion of regulation. A society that is held together just by compliance to rules is inherently fragile, open to further abuses which will be met by a further expansion of regulation. This cannot be enough. The virtues are not about what one is allowed to do but who one is formed to be."[54] The virtues can help us understand the context in which different practices in financial markets may be right or wrong; inform programs of education that combine technical knowledge with virtue ethics applied to business life; and help us see some of the shortcomings of regulatory responses to problems in financial markets.

[54] Bishops' Conference of England and Wales, *Choosing the Common Good*, 12.