THE CARITAS IN VERITATE FOUNDATION WORKING PAPERS

"The City of God in the Palace of Nations"

Beyond the Financial Crisis

Towards a Christian Perspective for Action

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With a selection of recent texts from the Church's engagement regarding the financial crisis

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SECTION TWO: Recent Church Texts on the Financial Crisis

Editorial

A financial crisis is usually the most visible element of a global economic crisis which hits everywhere on the planet, every sector, each and every one of us. Conventional wisdom holds that the financial crisis of 1929 led to the prolonged global economic crisis of that era. Some question this and instead argue that the 1929 financial crisis was not a cause but rather a consequence of the crisis. The same cannot be argued of this crisis however. As over the last 30 years finance has been the only generally accepted criteria of value creation, the 2008 financial crisis may indeed be seen as the source of the global economic crisis.

The focus on value creation, and value creation through finance, stems from a decline in *human values*. Finance has accelerated this decline after the fall of Berlin Wall and the rising tide of globalisation. The emphasis put on *transaction* (as opposed to personal relationship), and *monetisation* (of all and everything) became the prevailing values leading us to constant growth and development of the world. But this was an illusion. Considering finance as the criteria of value creation has on the contrary resulted first in *value extraction* and finally—in 2007/08—in value *destruction*.

Because the decline of human values has been a direct cause of this global crisis, it will require more than a change in the regulatory environment to enable us to restore the healthy development model that we need.

The decline of values is a direct cause of the crisis

For the last 30 years, true economic value creation has been confused with financial value creation as expressed by the stock market. Based on the assumption that markets cannot be wrong, all efforts have concentrated on how to increase stock prices, independently of the real value of businesses in terms of products, services, etc. The easiest way to increase that value was to focus on the growth of quarterly reports of companies. Regulators and economic actors made these quarterly reports obligatory worldwide, and imposed marked-to-market valuations of portfolios detained by the financial industry (banks and insurance companies, i.e. all of us), thus dramatically reducing strategic thinking, planning and investing. Corporate executives, encouraged by pension funds managers (again, meaning all of us), accepted being evaluated by financial performance. In exchange, they benefitted from stock options plans and bonuses linked to stock prices. As a result, they concentrated on devising short-term strategies, *financially* efficient but *economically* disastrous, as we can see with the decline of our long-term businesses. CEOs and senior executive teams, financial analysts and bankers, fund managers and institutional investors have gradually shifted their focus exclusively to short-term gains. Significant gains. The faster the time frame, the better. At the same time, governments have brought entire countries into unrestrained budgetary situations with the same mentality: delivering short-term benefits to the populace results in a good return in terms of election votes, and the resulting financing through debt has, as we have seen, become a strategic long-term nightmare as well as a short-term potential bomb. Here again, we are all involved: as beneficiaries of these deficit policies, but also as indirect lenders to these countries through our bank deposits, insurance premiums, and pension savings.

The decline of values—competence, courage, responsibility, respect, prudence, justice, moderation, honesty—has enabled all of this at all levels, not only in business but also in government. And once accepted the trend became irreversible: It became not only possible but almost easy to make fast fortune in business; It was for decades not only possible but practically required to craft state budgets based on deficit spending in order to be elected or reelected in politics.

The subprime bubble burst epitomises these moral and professional failures and is therefore a powerful indicator of this overall decline in values: the *greed for short-term gains* on the real estate market which drove modest households to borrow amounts disproportionate to their income; *no credit analysis* which induced humble people to go into personal bankruptcy; *no financial diligence*, leading to packaging irresponsible products with a simplistic rating; *no moral responsibility*, detaching revenue from risk in selling the package to a third party; *no sound analysis*, enabling buying those products to achieve a few basis point increased return, etc… In a nutshell, pretty much a list of combined faults. One simple objective shared from borrowers to lenders: make money (a lot), fast (very fast), and run (very far).

As a result, our children will inherit huge public debts and defaulted governments, a shaky financial industry and a fragile economy, and a lot of bad habits. Interestingly, those children seem eager to find solutions. And a lot of technical solutions have been considered over the last five years.

But we need more than technical solutions. In fact, to compensate for the decline in values, technical solutions like processes, rules, and regulations had already been devised over the years, long before the crisis. Instead of helping, those have gradually tainted all levels of our organisations, business as well as governments. A bit like Pravda, which claimed to tell the truth as it delivered lies, manuals of ethical conduct and processes devised by experts and consultants pretended to reduce the risks. Ironically, those have proven to be doubly false: first, they did not address the right issues, and in fact increased risks (the crisis is there to prove it, just consider the failure of the rating agencies). Second, they killed innovation and promoted financial and administrative profiteers who follow processes, instead of visionary people who make sound decisions. Changing more rules has been the main motto to avoid a new crisis. This may be necessary but is by no means sufficient if the value background remains unchanged.

The return to values has to precede the changing of rules

In reality, until now, too many rules have merely masked the generally accepted, yet ultimately flawed assumption that value creation has to be the criteria for development, and finance the criteria of value creation. Financial metrics are easy to implement, easy to monitor, easy to pilot. Reporting obligations, marked to market valuations as mentioned above, identical taxation for short- and long-term gains, stock option plans linking remuneration and share price, aggressive pension funds' investments into stocks versus bonds, etc.—all these measures and rules should be modified to restore long-term strategic thinking, innovation, and investment. They should be reformed in order to restore sound economic and social development. And nothing will be achieved without those modifications because no actor in business or politics can act virtuously if the rules are against him. But this is not enough.

To be really efficient, we need to consider how to restore responsibility, competence, courage, prudence, justice, moderation as generally accepted principles. We need to speak up, to write, to take a stance on the fundamentals, so that the rules are designed to fit a virtuous circle. Obviously, we have to apply this to our own way of acting, whatever responsibility we have: as managers in respecting and forming our people and promoting the right people; as investors in asking for responsible ways to invest our funds, individually or through our pension funds; as business leaders, in respecting our clients, suppliers, employees, the environment; as politicians in serving the long-term interests of the people and the security between nations; as board members in putting the right business leaders in place; as religious leaders in speaking up and telling the truth, especially when nobody wants to listen. And then, to propose technical solutions to fit these accepted principles.

In short, serving should become a priority and the common good a recognised objective. Indeed we should stop serving only ourselves and ditch individual satisfaction as the main evaluation criterion. We all know that human weakness will never allow a perfect world. But to emphasise at least the right principles and virtues would help all people of goodwill to enable the world to become a better place. It would also reduce the risk of another impending financial and economic crisis. Changing the rules without addressing a fundamental change in values would leave the common good a second-class goal. It is because we try to stick to flawed principles that nothing has changed during the last five years.

Symmetrically, hoping for the best without taking practical measures will guarantee failure. So we definitively need both: a strong moral awakening and a global reflection on a regulatory environment enabling long-term development of the planet. Let us all advocate for replacement of accepted principles and at the same time request the implementation of proper changes in existing rules and regulations to discourage short-term thinking, encourage sound development (every person and the whole of each person) and minimise the enormous risks looming for the next generations.

SECTION ONE

TOWARDS A CHRISTIAN PERSPECTIVE FOR ACTION

BEYOND THE FINANCIAL CRISIS: TOWARDS A CHRISTIAN PERSPECTIVE FOR ACTION

A Caritas in Veritate Foundation Report[1] by

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¶ Introduction

What are the lessons that a 'Catholic perspective' should or could help to draw from the ongoing economic and financial crisis? What does 'Catholic perspective' mean? Does it necessarily imply a 'naïve' or 'uninformed perspective' or is it simply a perspective which attempts to go beyond technicalities, so as to look at the philosophical and anthropological assumptions on which technicalities—real and intellectual—stand? In this sense a 'Catholic perspective' would mean discussing the conclusions of technical analysis in the light of values and principles as mediated by the principles of Catholic Social Teaching and ultimately derived from our faith in Jesus Christ? According to our view, economists and social scientists must be aware of technicalities, but must also reach beyond them. Indeed, we are convinced that no meaningful lessons can be drawn from the crisis unless the analysis extends beyond the received wisdom offered by social and economic science, to encompass the values and assumptions on which every diagnosis or remedy should stand.

"No meaningful lessons can be drawn from the crisis unless the analysis extends beyond the received wisdom offered by social and economic science, to encompass the values and assumptions on which every diagnosis or remedy should stand."

The Chinese word *wēijī* means crisis, but it also may simultaneously mean danger and opportunity. In this sense, the crisis is a double opportunity: an opportunity to better understand the world and an opportunity to design the most appropriate directions for actions in the future.

Clearly the financial and economic crisis unfolding for nearly seven years now has taken the world by surprise and is unveiling almost daily those aspects of the working of the global economy that went unnoticed or unaddressed for decades. This simple fact suggests that our present understanding of the world economy and finance is still not complete, and that critical elements are either false or missing. Indeed the first lesson stemming from the crisis is that the world economy since 2007 has behaved differently from the predictions of received wisdom which until recently seemed unassailable. The answer given in 2009 by the British Academy of Sciences to the benign question asked by Queen Elizabeth when Her Majesty visited the London School of Economics in November 2008 gives an idea of how self-confident and self-referential is the dominant world-view (*see* Figure 1).

The crisis thus grants an opportunity to challenge the popular conceptual models for the economy and society, models which adhere to 'natural' categories of markets and self-interested individuals. By accepting the risk of close contact with reality, the Christian perspective rooted in the long

Figure 1: "Why did no one see the crisis coming?"[2]

- *"It is difficult to recall a greater example of wishful thinking combined with hubris."*
- *"But the difficulty was seeing the risk to the system as a whole rather than to any specific financial instrument or loan."*
- *"People trusted the banks whose boards and senior executives were packed with globally recruited talent and their non-executive directors included those with proven track records in public life."*
- *"They believed that the financial wizards have found new and clever ways of managing risks."*
- *"…a failure of the collective imagination of many bright people, both in this country and internationally, to understand the risks to the system as a whole."*

Excerpts from the British Academy of Sciences response letter to Queen Elizabeth, 22 July 2009

tradition of the Social Teaching of the Church avoids being trapped in pure idealism or ideology as is the case of the still-dominant economic theory. The crisis compels us to change our perspective by going to the periphery, as Pope Francis often says, and to look at the world from there.

This report is made of three parts. Part I is rather technical in the sense that it shows how the mutual relationship between States and Markets has progressively changed since the end of WWII to the advantage of Markets. Part II examines some dominant features of the world economy in light of these systemic changes and identifies a number of deepening asymmetries which may be attributed to these changes. Throughout, the term 'asymmetry' is systematically preferred in order to avoid implicit value judgments. In its broad sense, 'asymmetry' means a lack of harmony, balance, or proportion; even possibly a lack of justice. Indeed, the Christian perspective extends beyond these mainly aesthetic considerations to consider the dimension of justice and the actions that may be needed to restore or support it.

The Christian 'lens' comes truly into play in Part III. It first discusses the anthropological, social, and economic content of the notion of the Common Good. The Common Good is indeed the cornerstone of Catholic Social Teaching and all of its other principles—solidarity, subsidiarity, the universal destination of goods, the preferential option for the poor, etc.—derive and relate to it. But the Common Good extends beyond our earthly realities as, according to St Thomas Aquinas, only God is its ultimate perfection and horizon. Because of this metaphysical dimension, the Common Good fundamentally differs from any human-designed utopian society, as such is also bounded by man's earthly aspirations.

Part III then goes on to identify directions for action inspired by Catholic Social Teaching which would help to mitigate or even correct some of the most flagrant asymmetries and denials of justice. Such actions would set the world on the path of the Common Good. Indeed, it provides a horizon for human action even if it is out of reach by purely human efforts. Christians have a moral duty to act in favour of the Common Good even if they know that ultimately only grace is efficient.

PART I
LONG-TERM STRUCTURAL TRENDS IN THE GLOBAL ECONOMY

¶ Markets contained by States: The 'Bretton Woods system'

In July 1944, 44 national delegations gathered in the Bretton Woods Hotel Resort in New Hampshire to prepare the institutional framework for the post-war global economy. The Conference lasted for three weeks and indeed succeeded in setting the framework for post-war international economic and monetary relations. The coherent set of institutions and rules addressing major economic questions was in fact part of a broader construct—the United Nations system. The whole UN system was conceived of as 'international', i.e. composed of Westphalian-type sovereign states. Such a system rested on two important principles:

- For internal, domestic affairs the States are sovereign, which means that they reach decisions without external interference;
- For international affairs, States enter interstate agreements which they commit to obey under the fundamental principle of international public law: *pacta sunt servanda.*

By extension, the same international logic applied to the 'sub-system' of economic and monetary agreements reached in Bretton Woods.

The delegates meeting at Bretton Woods still had a clear memory of the pre-war economic and monetary crisis which was one of the important causes of WWII. Therefore they first aimed at providing the world with an institutional setting able to prevent the same sequence of events from happening again.

Despite some political disagreements between the United States and the United Kingdom, the conference succeeded in crafting a general agreement about the principles along which the new 'system' should work, and in setting the corresponding institutional framework.

The logic of the 'Bretton Woods system' (hereafter BWS) can be summarised by spelling out its three main principles:

- ***Free trade should progressively prevail in the post-war world.*** The process of dismantling protectionist barriers should be implemented on a smooth and mutually-agreed basis. Indeed, according to view prevailing both then and now, free trade always benefits all partners—albeit possibly in uneven proportions. In other words, increased international specialisation enhanced through free trade was expected to unleash an additional source of economic growth. By trading with one another, previous enemies will also build mutual confidence and trust. The world will thereby progressively be more inclusive and thus more peaceful. One should remember that the exclusion of Germany after WWI from international economic life was certainly one of the meta-causes of WWII.

- ***Smooth international trade requires a well-functioning and safe payment system.*** The Bretton Woods conference reached three important decisions in the field of international monetary relations: 1) States joining the system would have to accept as a goal the convertibility of their currency, but only for current account transactions (i.e. trade and transfers); 2) once declared convertible, the currencies would have an internationally agreed, stable exchange rate to the US dollar; 3) the US dollar will be convertible at a fixed and internationally agreed price into gold. This means that States agreed to surrender their exchange rate policy to international agreements and, as in counterpart, they preserved their internal monetary autonomy[3].
- ***Current account imbalances are the main systemic risk.*** While the British believed both surplus and deficit situations were equally dangerous for the stability of the system, the ultimately-adopted American position saw only deficits as a serious danger. BWS thus built a three level response to situations of current account deficits, according to their gravity: 1) for temporary deficits: unconditional but limited lending by the International Monetary Fund; 2) for lasting or structural deficits: restructuring advice and conditional lending; 3) for systemic imbalances: international re-negotiation of exchange rates. On top of these normal remedies, BWS also allowed a series of 'safeguards' that countries in trouble could activate by suspending temporarily their international commitments.

These three principles were the basis for the three institutional pillars of the BWS: the World Trade Organisation (previously GATT), the IMF, and the World Bank (previously IBRD). From today's perspective it is clear however that three main areas were left outside of the Bretton Woods agenda and thus remained institutionally unaddressed by the system, each one of them for different reasons:

- The modern 'development agenda', mainly because most of the countries today called 'developing' or 'emerging' were then still part of colonial empires;
- Agricultural trade issues, because the US in 1949 refused to ratify the statutes of the still-born International Trade Organisation;
- International private capital (i.e. financial) flows, for reasons difficult to fully appreciate today—the most convincing argument is of a 'lack of imagination'. At the time of Bretton Woods in 1944, and until the

"At the time of Bretton Woods in 1944, and until the 1960s, very few could imagine how important international private capital flows would become."

1960s, very few could imagine how important international private capital flows would become. In the inter-war period, which served as reference to the works of Bretton Woods Conference, private flows were limited to direct investments.

The break-up of the Bretton Woods system

Tensions in the BWS started to appear by the early 1960s as the widening US trade deficit began to threaten American gold reserves. In order to alleviate tensions with the US, the main partners of the system agreed by 1961 to abstain from requesting that deficit countries settle outstanding balances in gold. By doing so, the BWS was transformed from a *de jure* hegemonic and US-centred system, into a less asymmetric system, where some consensus among the big players was required.

The 'gentlemen's agreement' was however not enough to save the BWS. On 15 August 1971, US President Richard Nixon announced that the United States had unilaterally decided to suspend the convertibility of the dollar into gold[4].

This unilateral and largely unexpected American decision delivered a deadly blow to the logic of the BWS[5]. Once the fixed dollar–gold exchange rate was floated, the 'dollar exchange system' had lost its anchor and the BWS its raison d'être. Nixon's decision freed the US from the need to gain the consensus of partners, and has established a *de facto* fully US-centred 'dollar standard'—still largely prevailing today. Indeed, efforts after 1971 by groups of countries to maintain stable—or even managed—exchange rates between their currencies remained largely unsuccessful. Only after nearly three decades did the European Union manage to agree on monetary integration by introducing the €uro, in 1999.

The American decision to let the dollar float irrespective of the global consequences may be seen not only as an answer to the US economic disequilibria (which seemed temporary at that time), but also as a response to deeper pressures rooted in changes shaping the global economy, namely the strengthening of private financial flows. Today, it is clear that during the years before 1971, private finance emerged—and was allowed to do so—as a new but increasingly important phenomenon, potentially threatening the premises of Bretton Woods logic.

Until the late 1950s, private financial institutions, assets, and transactions were mainly domestic[6]. The relevant financial regulations were also internal, in the hands either of the central banks or of ministries of finance. During the 1960s, the development of international private financial flows was facilitated by the progressive lifting of administrative controls on private capital movements and by the subsequent extension of convertibility to capital account transactions. These measures, not required by IMF statutes, were amplified by independent transformations of the international financial landscape. These transformations resulted in steeply increasing volumes of trans-border private financial flows:

- ***The euro-dollar.*** In the mid-1960s the unprecedented financial innovation of the euro-dollar opened new horizons in international financing possibilities. Euro-dollar balances were made of dollars held on the balance sheets of banks outside the regulatory reach of US domestic authorities and available to international actors for the financing of their transactions outside of the US. The euro-dollar was *de facto* a technically unlimited source of dollars (through credit) to be used outside of the US. Such an uncontrolled private source of dollars was a clear challenge to the US Federal Reserve on its own turf. Not unreasonably, the invention of the euro-dollar is attributed to Soviet intelligence. This ground-breaking financial innovation fundamentally changed the balance of power between States and Markets;
- ***Access to monetary gold.*** Until 1967, access to monetary gold was strictly limited to central banks. In 1967, under pressure from private financial players, the London gold market opened a window for private non-industrial transactions. As the fixed dollar-gold exchange rate still prevailed, this move allowed private actors to enter arbitraging activities which potentially directly threatened US gold reserves;
- ***Technological changes.*** The late 1960s were also the years when major advances in telecommunications and information technologies started to emerge. Banks—whose main activity is information-related—were among the first players to identify new opportunities. Consequently, they start to internationalise by opening affiliates and subsidiaries abroad, mainly in major financial centres such as London, New York, Paris, and Zürich.

French economist Jean Fourasité once called the thirty years between 1945 and 1974 '*Les 30 Glorieuses*'; in the United States, this period is referred to as the 'Golden Age of Capitalism', marked by sustained growth, low unemployment and inflation, and limited public and balance of payments deficits. The de facto devaluation of the US dollar in 1971 and the subsequent reaction of oil exporting countries steeply revaluing the price of oil in 1973/74, were the expressions of fundamental changes in the modus operandi of the global economy. The three decades that followed (mid-1970s–2007) can be called the 'Age of Euphoric Finance' as they were characterised by the growing empowerment of Markets over States as the dominant mode of coordination for trans-border economic activities.

States overwhelmed by Markets

¶ Enhancing economic efficiency: The ideal bias

Why did sovereign States, parties to the Bretton Woods agreements, not agree on masterminding the evolution of private finance by adapting the international framework before it was too late? Why have private forces been allowed to triumph over international agreements? The most plausible explanation is the lack of vision and growing scepticism among States, especially the US, about the possibility of reaching a new long-term international agreement on international money and finance conforming to their conflicting strategic and economic interests. In the early 1970s, the US and UK had a lot to gain from a development pattern of international finance in which Anglo-Saxon banks, financial centres, and technology providers played a leading role. Thus, the 1971 decision of the US President to 'suspend' convertibility of the dollar can be seen as an attempt by the US to gain the first-mover advantage in a situation where the BWS was heading for an unavoidable collapse due to the politically-unchecked emancipation of private international financial flows.

Such a non-regulatory approach to nascent international finance strategy was in tune with the much broader neo-liberal ideas growing in influence in the Anglo-Saxon world and also in some leading international organisations such as the OECD and IMF. Neo-liberalism may appear, at first glance, as the extension to other international flows of the more traditional free-trade principle. However, neo-liberalism is much more than that: while free-trade calls for the abolition of border controls, neo-liberalism as a political programme proposes curtailing any state intervention. The critical neo-liberal economic argument has always been that any state intervention or regulation distorts the functioning of markets and hence reduces overall efficiency and the aggregate level of output. This forceful argument rests on two highly disputable assumptions: 1) 'competitive markets' are the natural forms of social organisation; and 2) they are expected to appear spontaneously in any social space freed from regulation. These two assumptions are anything but intuitive. They were and still are strongly disputed also within the liberal camp, for instance by the 'fathers' of *Ordo-liberalismus* such as Wilhelm Röpke. Despite the presence among Christian thinkers of prominent advocates of neo-liberal ideas, such as Michael Novak, the teachings of the Magisterium in the field of Social Doctrine have never adhered explicitly to these two assumptions.

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The fall of the Iron Curtain in 1989 provided additional ground for and reinforced growing popular trust in the natural source of market forces driven by no-less natural private interests while discarding almost any state regulation. By the early 1990s, the world was seen by many as reaching the 'end-of-history' stage. This expression, coined by Francis Fukuyama, is characteristic of the state of mind that prevailed in the West from the Margaret Thatcher and Ronald Reagan era until at least 2007. In this context the famous statement 'there is no alternative' (TINA) attributed to Thatcher means simply 'there is no alternative to the market'. Later on, the so-called 'Washington consensus' emerged from the same intellectual context. It was widely accepted as the expression of 'ultimate' economic wisdom and used as a blueprint by international organisations.

¶ Emerging trans-national economy

The collapse of the BWS can be seen as a victory of private market logic and forces over the classical inter-state logic. This breakthrough contributed to changing fundamentally the way the global economy operates: from a largely ***inter-state (inter-national)*** mode of operations in place since the late 1940s, the global economy started to move towards a ***trans-national*** one. Until 1971, inter-state borders structured the world into autonomous 'boxes' of national economies made of more or less managed internal markets, and connected with the outside world by flows of trade and payments. This institutional framework rested upon inter-state agreements, functioning according to principles of public international law. During the 1970s the density of economic interactions between the national economies started to increase rapidly. Trans-national networks of enterprises, of markets, and of the ownership of assets or liabilities transformed a world of self-contained boxes into a complex web of interdependencies. Today, the heterogeneous elements (states, markets, trans-national enterprises and banks) continuously interact across political borders according to their own preferences and objectives. These complex interactions are governed by a heterogeneous combination of private and public institutional, legal and para-legal norms and arrangements (standards, rules of conduct, soft-law). In this configuration—as the present crisis has shown convincingly—interactions are at least as important as the components or elements of the system themselves. In fact, by becoming trans-national, the global economy has also become a 'system', i.e. a network of non-hierarchical interdependencies.

Therefore the working of the post-Bretton Woods global economy has to be analysed on at least three levels: 1) ***macro-economic***, which captures the question of imbalances and of the changing roles of central banks; 2) ***meso-economic***, which addresses the emergence of transnational financial interactions; 3) ***micro-economic***, which allows for stressing the importance and rationality of new actors.

¶ Persistent international imbalances

Flexible exchange rates were initially seen as only a transitory solution. Indeed, the consensus lost in 1971 on the need for a holistic approach to global monetary and financial issues has not been rebuilt until now. The €uro-zone is the only significant exception.

In the early 1970s, the shared expectation based on received theory was that under flexible exchange rates, international trade disequilibria would disappear almost automatically. Excess imports of one country were expected to feed into excess demand for the foreign currency leading to a depreciation of the domestic currency, thus automatically limiting imports and contributing to the subsequent current account adjustment. According to the theory, countries were therefore expected to rely more on the equilibrating role of foreign exchange markets and would not need to build up official reserves (such as gold or dollars), as was the case with fixed exchange rates. Furthermore, the flexible exchange rate regime was expected to provide additional autonomy to national policies even in countries otherwise closely economically integrated. This increased autonomy was seen by many as a clear advantage in comparison to the fixed exchange rate regime under which the monetary policy of the US significantly impacted its partners.

From 1971 on, the economic environment for international traders of goods and services has fundamentally changed. Under flexible rates, they need to take into consideration not only the prices of traded goods, as in fixed rate regimes, but also the possible variations of exchange rates. In this sense, the break-up of the BWS has de facto 'privatised' the exchange rate risk. This situation of increased volatility appealed to financial players and attracted them to foreign exchange markets. Today these markets are used today—in uneven proportions, as will be discussed later—by two categories of actors: 1) exporters and importers who hedge and cover the exchange rate risk of their trading contracts; and 2) financial operators who trade in currencies and related instruments as they do in any other financial assets, with the sole purpose of making profit in the margins.

"From their inception, foreign exchange markets have been driven at least as much by financial and speculative concerns as by current account and real economy ones. In fact, foreign exchange markets which theoretically were expected to deliver current account equilibrium resulted in contributing to deeper imbalances and higher volatility in the market."

The effectiveness of the flexible exchange regime rapidly proved quite different from expectations. From their inception, foreign exchange markets have been driven at least as much by financial and speculative concerns as by current account and real economy ones. In fact, foreign exchange markets which theoretically were expected to deliver current account equilibrium resulted in contributing to deeper imbalances and higher volatility in the market. As shown by Figure 2, in 2010, according to the figures of the Bank for International Settlements (BIS), the turnover on foreign exchange markets has been approximately 23 times gross world product (GWP), which corresponds to approximately 80 times the value of world exports.

After 1971, current account imbalances did not disappear from the post-Bretton Woods economic landscape. Quite the opposite, in fact. In aggregate terms—as shown in Figure 3—they today amount to about 1–2% of GWP. On the deficit side the United States and the €uro-zone (i.e. Germany) play a prominent role, with China, Japan, and oil exporting countries as counterparts on the surplus side.

From a purely technical perspective, current account disequilibria can persist as long as the corresponding financing is provided by the continuous flow of international capital transactions. These include all kinds of lending and borrowing operations as well as transactions on financial or real assets—implying the international transfer of ownership of these as-

Figure 2: Annual non-derivative foreign exchange transaction by % of corresponding GDP[7]

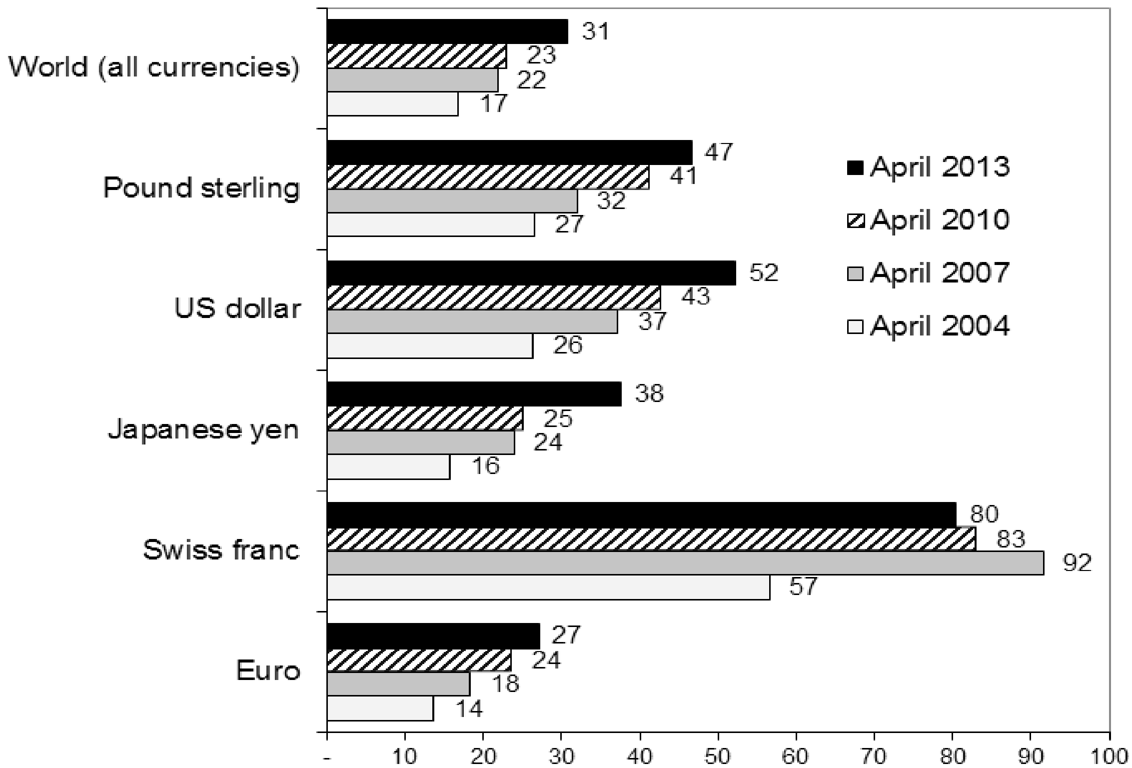
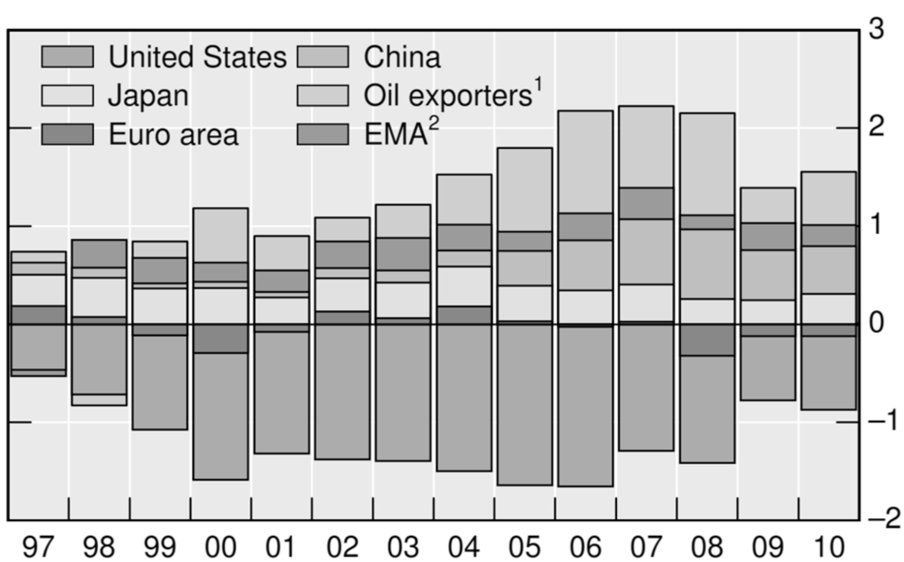


Figure 3: Current account balances as a % of GWP[8]



sets. These transactions build up a web of trans-border interdependencies which is continuously growing in size and complexity far beyond what the amount of imbalance would suggest. Indeed, Figure 4 provides an approximation of the gross volume of cross-border financial transactions, of which imbalances are only the net expression. Until 2008, these transactions were

20 to 30 times larger than net current account imbalances. This reinforces the point that in normal times and for the major world currencies, balancing the needs of current accounts contributes only marginally to foreign exchange rate levels.

Trapped between money and finance: New roles for central banks

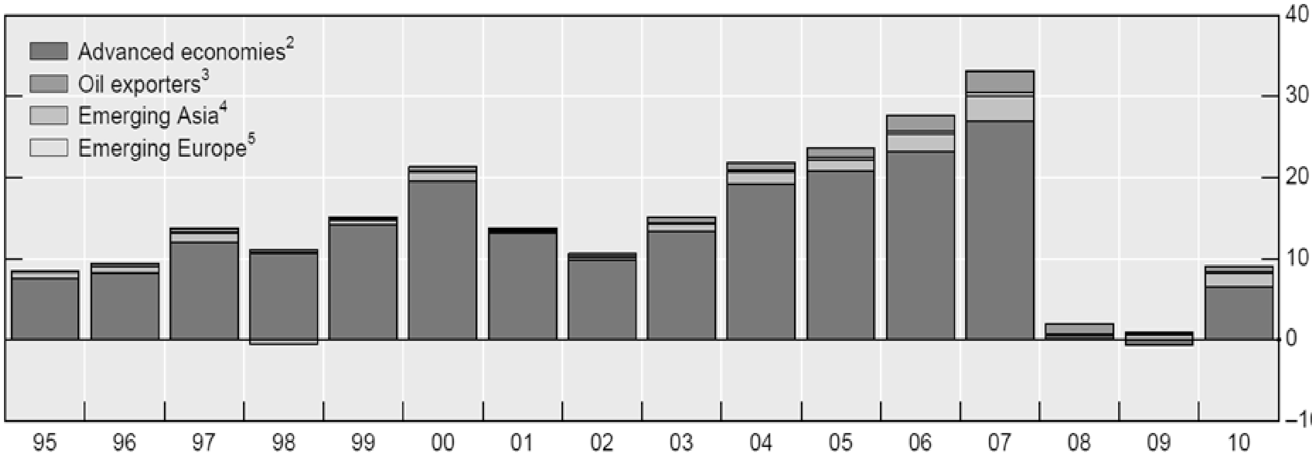
In the post-Bretton Woods context of unleashed markets and dormant states, the mandates of central banks were adjusted to the new situation. This was done in two ways: 1) in most countries, the independence of central banks from the government was reinforced so as to shelter money creation from political influence; 2) the mandates of central banks were narrowed to focusing on consumer price stability. Consequently, financial markets—especially asset price booms and bubbles—as well as the general condition of the economy—the US Federal Reserve being a significant exception—remained, until the crisis, outside the mandates of central banks.

The flexible exchange rate regime, together with free movements of capital and the growing variety of financial assets increased the spectrum of possible instruments to be used for international payments, transactions, and the holding of reserves. Thus, central banks of surplus countries have today the possibility of holding high quality foreign assets rather than keeping foreign currency in idle cash. This means that as long as countries with persistent current account deficits manage to generate high quality (i.e. low risk) financial assets which are agreeable to surplus countries, they do not need to fear a massive depreciation of their currency. This privileged situation has been the case for the last three decades for the US. Indeed, in present conditions, not only currency may pay for excessive imports, but also high quality assets (financial or real). Today this is precisely the case, as countries with persistent current account deficits—like the US and some European countries—are particularly competitive in generating a continuous flow of high-grade financial assets such as start-ups, shares of existing listed companies, corporate bonds, and state bond bills. Ultimately, these assets—and not currency—are used by surplus countries as means of international reserves. This situation could well mean that we are, de facto, in an 'Asset Exchange System' where the difference is progressively fading between currency and high-grade financial assets (quasi-money) as means of payment.

"This situation could well mean that we are, de facto, in an 'Asset Exchange System' where the difference is progressively fading between currency and high-grade financial assets (quasi-money) as means of payment."

Today, the classical distinction between money and financial assets has lost it clear-cut character and has been replaced by a continuum of quasi-money payment instruments with different degrees of liquidity. The pricing of the relevant liquidity premiums and related risks was left to unregulated markets. Until 2007, this shift from money to the use of liquid financial assets for payment and reserve purposes had barely been noticed.

Figure 4: Gross capital flows as a percentage of GWP[9]



It became visible when liquidity drained in some market segments, initiating a potentially suffocating domino effect. Central banks had then to intervene by massively employing 'unconventional instruments' to pump oceans of high-powered central-bank liquidity into the economy. As these high-powered credit lines were primarily used by financial intermediaries to strengthen their balance sheets, they unsurprisingly did not reach the real economy.

Foreign exchange: New class of financial instruments

Shortly after 1971, a handful of national currencies became a specific class of financial instruments traded on dedicated foreign exchange platforms (forex) which quickly became among the biggest and most active financial trading arenas. Despite their role in the global economy, forex markets are neither organised nor supervised. Rather than markets in an institutional sense, they are simply interconnected closed networks of trading desks. It is worth stressing that more than 90% of foreign exchange transactions take place between two financial actors. This means that only 10% of these trades involve at least one 'real-economy' party. Put differently: An imaginary buy/sell of foreign exchange ultimately involving two real-economy parties is intermediated by 18 transactions among financial players.

> **"An imaginary buy/sell of foreign exchange ultimately involving two real-economy parties is intermediated by 18 transactions among financial players."**

As early as 1973, with the first oil shock, it became obvious that global trade and finance were in fact using a handful of national currencies. The present concentration of foreign exchange transactions in so few currencies can be explained by: 1) related political and economic influence; 2) liquidity of national financial markets; 3) economies of scale in providing trading and settlement facilities; and 4) the demand for extreme liquidity. Figure 2 compares the volumes of foreign exchange transactions in national currencies with corresponding gross national products.

The primacy of the US dollar in this respect is evident even if the international role of the €uro is systematically growing. Indeed, if one takes the US and €uro-zone products as roughly equivalent, foreign exchange transactions involving the €uro were in 2004 about 50% of those involving the dollar, while in 2010 the proportion was 60%. When one national currency plays a central role in international exchanges worldwide, it gives that country a *seignoriage*-related advantage. Both this advantage of the US dollar and its asymmetry in regards to other major currencies have persisted with the flexible exchange regime. Since 2004, the *seignoriage*-related advantages for the US have started to be shared—but not yet challenged—by the €uro.

Commodities and the conquest of new asset classes

In recent decades the discovery, creation, and exploration of new asset classes has been an important dimension of financial innovation. For a time, real estate prices, mortgages, and other credits packed into collateralised debt obligations (CDOs) and other instruments played this role, attracting (too) much attention. Today the same has started to be the case with insurance linked securities (ILSs). During the last decade, commodities have also been heavily transformed into financial assets, as they have presented an interesting possibility for diversifying financial risk. As King Midas with gold, 'financialisation' is the process by which finance expands into new domains and transforms into speculative assets anything it touches.

"As King Midas with gold, 'financialisation' is the process by which finance expands into new domains and transforms into speculative assets anything it touches."

Many commodities, vital to the proper working of the real economy, are traded in well established markets initially created to provide 'real' services to producers and customers. Some commodities, such as gold or oil, have historically deep markets and a long established role in financial strategies. Since the mid-1970s, the number of commodities having a more or less organised market with related financial derivatives has been steadily increasing. The financial 'take over' of other commodities is more recent—it was especially visible during the early 2000s. Figures 5 and 6 show the growth in the volumes of financial instruments used in commodities markets.

When financial motives dominate transactions in 'real' markets, two consequences follow. Firstly, commodity prices become 'financialised', and thereby more volatile and correlated with other financial markets. In the medium term this may lead to a loss of interest in these assets by the financial community. Secondly, before this potential loss of interest, prices of real goods come to depend less and less on the movements of real supply and demand. The macro-economic benefits derived from risk diversification by using commodities for financial purposes tend to be short lived, whereas real micro-economic consequences for commodities producers and consumers may extend for longer periods and be strongly negative

Figure 5: The price of commodities gets 'financialised'[10]

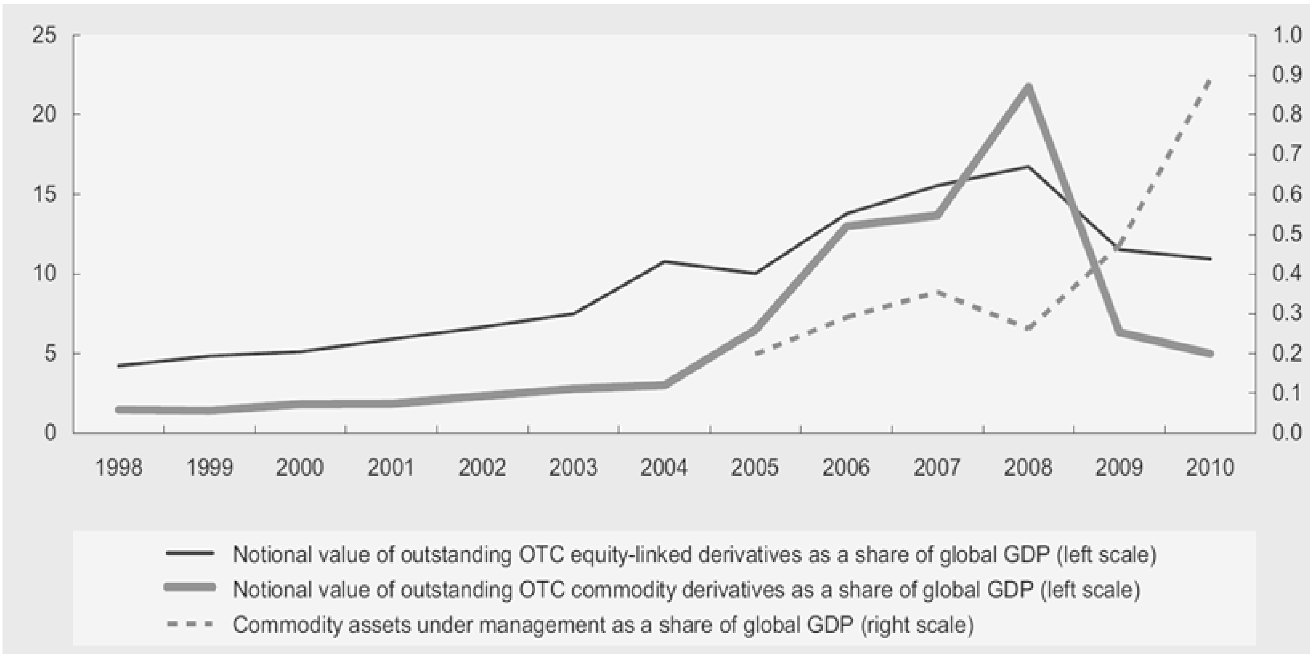
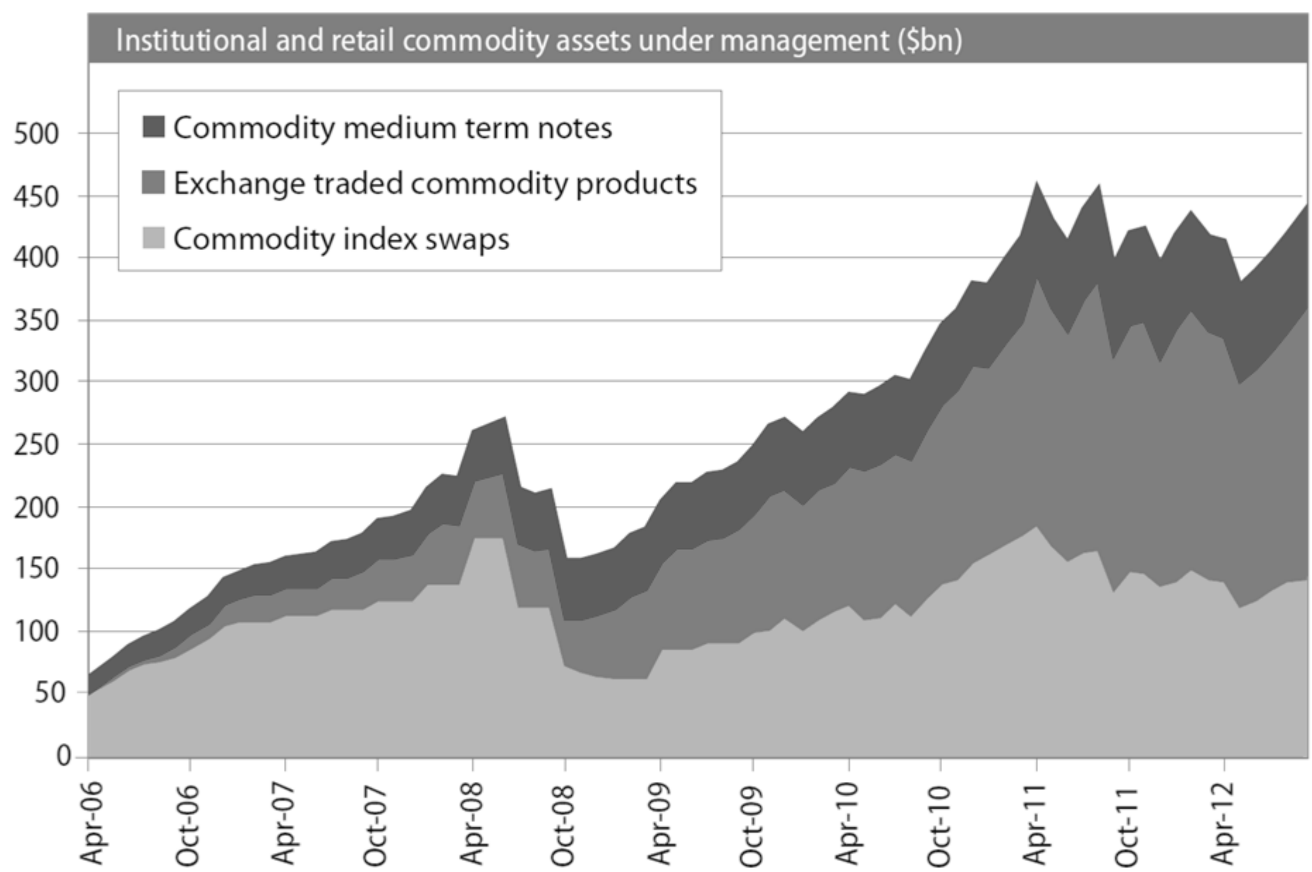


Figure 6: The financialisation of commodities markets in $ billions (US)[11]



> **"The macro-economic benefits derived from risk diversification by using commodities for financial purposes tend to be short lived, whereas real micro-economic consequences for commodities producers and consumers may extend for longer periods and be strongly negative for the poor."**

for the poor. Financialisation of commodity prices and their subsequent increased price volatility produce asymmetric effects. Any food price rise is a cause for immediate concern for poor households as their purchasing power automatically diminishes. On the supply side, any increase in production induced by higher prices—in theory to the benefit of the poor—requires time to appear in the market. This higher production may reach the markets in times when the upward trend in prices is reversed. Consequently, financialisation-related volatility of food prices may exacerbate rural poverty and hunger.

The long-run effects of food price volatility are particularly negative for low-income countries where agriculture still represents a large share of either or both national output and national consumption. In these cases, a rise in prices immediately hurts poor consumers, while providing little expected benefit to poor producers, who face the risks connected to volatility. Conversely, falling prices tend to permanently worsen the supply side, as farmers may be induced to leave the countryside, to disregard existing investments, and to abandon farming land, which will easily deteriorate into wilderness.

New functions of finance: The risk and return management

The expansion drive of financialisation is nothing other than a tangible expression of the shifting expectations regarding financial returns and risk management. This shift in expectations translated into an exploding demand for financial expertise, instruments, techniques, and knowledge. On the supply side, this demand was matched by new conceptual and technical answers that grew out of a brand new science called 'market finance'. The 'founding fathers' of this new science introduced in the late 1960s a new rationality to financial activities based on the risk-return paradigm and provided this rationality with adequate tools for action. Only much later were the 'founding fathers' awarded Nobel prizes to join the pantheon of the still-dominant economic theory: H. Markowitz (1991), M. Miller (1990), F. Modigliani (1985), E. Fama (2013), or W. Sharpe (1990). As a consequence of this paradigm shift initiated half a century ago, the role of finance in modern economies has fundamentally changed.

In a traditional macro-economic vision, two main roles are assigned to the financial sector. On one side, it is expected to provide payments infrastructure and services (national and international), while on the other side, its role is to allocate collected savings to viable economic projects and, potentially, to help in trading the corresponding financial assets.

In the aftermath of the collapse of fixed exchange rates, financial activities took on a growing importance in the *modus operandi* of the international economy, especially with the opening of new possibilities for international (public and private) lending and borrowing as well as for the financing of trans-border private activities. By the same token, growing international financial markets (the so-called euro-markets) appealed also to governments who saw in them a source for cheap and abundant funding. This opened new horizons to public policy and made national public deficits seem less problematic. As a consequence of the softening of financing constraints, public deficits and debt started to grow.

On the basis of its two classical functions—payments and financing—and boosted by this paradigm shift, modern finance developed a third—now autonomous—function: assessing, managing, and allocating risk. Up until then, risk allocation was narrowly intertwined with the financing of otherwise illiquid projects: once credit was granted, the relevant risk remained on the balance sheet of the lender. New instruments, markets, and techniques such as securitisation and derivatives have made it possible to trade risk separately from the underlying asset. These innovations generated liquid markets for risk instruments and allowed a full-fledged macro-level emancipation of the risk allocation function. Today this function accounts for a large part of the activity of the financial sector.

"On the basis of its two classical functions—payments and financing—and boosted by this paradigm shift, modern finance developed a third—now autonomous—function: assessing, managing, and allocating risk."

The roots of the risk and return paradigm, the pillar of market finance, are both in academia and in technology. Risk measurement techniques, as well as the notion of risk diversification are a consequence of a conceptual breakthrough by H. Markowitz and his fellow Nobel prize winners. Information technology provided the tools necessary for the industrialisation of these techniques and their use in almost-real time. The contemporary techniques known as 'high-frequency trading' or 'nano-trading' are nothing more than the sophisticated use of present technological possibilities in line with the conceptual breakthroughs of the 1950s.

These possibilities started to be implemented at a large scale in trading rooms, accounting practices, and in academia in the early 1970s. The promises of the risk and return paradigm and related management techniques were in line with the existential fears and corresponding demands of an aging but every year wealthier Western population. This population discovered in financial techniques and markets a tool for providing for their old-age pensions as their families and traditional social structures started to fall apart. The idea that finance techniques would be able to provide a secure income out of savings accumulated during one's working life was very comforting in a time of expanding individualism and the search for self-sufficiency.

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This suggests that there was a social demand for risk management which coincided with what information technology, regulatory frameworks, and intellectual tools were—supposedly—able to deliver. So already in the late 1970s, retail products and services focusing on 'risk management' found their way into the market. Later on, regulatory frameworks adapted accordingly—as with the British Big Bang of 1986.

The underlying rationale of a major part of contemporary financial activity is the management of risk and return. From the perspective of wealth or asset management, the economy and society appear as if made up of different but interdependent bits and pieces of reality and more or less corresponding financial assets. While the bits and pieces are moved by real processes, financial markets value each asset according to these 'fundamentals' while also taking into account their relation to other financial assets. In this way, risk and return characteristics are identified and the market prices the assets accordingly. In the world of assets, the financial wealth manager constantly 'picks and chooses'—i.e. analyses, assesses, and selects—the most appropriate configuration of assets so as to maintain the risk and return profile of the institution, fund, or portfolio he manages in line with his strategy or client's expectations. The proliferation of investment funds specialising in a given asset class, investment style, or approach delivers to the retail client the possibility of taking advantage of diversification even with a small investment, while at the same time building an additional layer of intermediation.

The 'financial manager' plays a prominent role, as he or she is empowered—directly or indirectly—by wealth holders to evaluate the risk and return perspectives of any asset and adjust the portfolio composition accordingly by buying or selling, often without direct relation to the economic performance of the underlying activity. Indeed, asset selection and allocation are seldom based on absolute performance, as finance widely uses comparisons such as benchmarks or rankings. This means that every asset (currency, enterprise, government, etc.) is not judged on its own merits but is compared to others in the same asset class. These methods and approaches of external evaluation feed volatility and liquidity into markets on which financial managers earn part of their living. By the same token however, they increase the distance and magnify asymmetry between the active and potentially versatile asset manager and the underlying social and economic reality, leaving the latter with a high degree of insecurity as to the financial verdict on its management decisions.

Transnationalisation of production

During the three decades discussed here, driven by an unprecedented reduction in tariffs, the share of exports in gross world product (GWP) almost doubled: from 15% in 1974 to 29% in 2008[12]. During the same period, trade composition also greatly changed: intermediate goods and services today make up 90% of world exports, up from 50% in 1950. Intermediate (or semi-finished) goods and services are incorporated into final products or more sophisticated intermediate goods in successive steps of transformation. In fact, increased trade in semi-finished goods indicates that another change has occurred in the global economy:

the process of the 'transnationalisation of production'. Transnational corporations—'global giants'—have been prominent drivers of this process in the ever expanding networks of their subsidiaries, affiliates, strategic partners, and suppliers. Experts in transnational production and distribution, these enterprises have developed their competitive edge in masterminding the circulation of intermediate goods and services across distant production sites, many of which they own or control strategically.

In fact the deepening 'transnationalisation of production' also has its financial dimension which can be called the 'transnationalisation of ownership'. Many of the remote production sites belong to the 'global giants' and as such are part of the foreign investment position of their home countries. According to the BIS, the level of aggregate cross-border investment positions (including portfolio as well as direct investment position) has increased between 1981 and 2012 from about 10% of GWP to over 150%. Even if the bulk of this rise is related to purely financial positions, direct investment holdings have most probably also progressed at least at the same pace as trade flows[13]. These cross-border investment positions are 'stock' data. As such they do not capture the yearly gross flow of trans-border transactions on corresponding financial and real assets. According to BIS/IMF estimates, the gross (not net) capital flows have grown from about 10% of GWP in 1995 to about 35% in the wake of the financial crisis.

Figures on trade, investment positions, and gross financial flows give an idea of the way the contemporary transnational economy works: intermediate goods and services are steered through a number of highly specialised and geographically scattered sites of production and distribution before they reach the final customer. World class operators listed on major stock exchanges own or control many of these production sites or distribution channels. The contemporary 'transnational economy' is able to work in the context of flexible exchange rates and global open markets because the 'global giants' have become experts in careful optimisation—locational, technical, economic, financial, fiscal, and regulatory—of their operations, in the management of their tangible and intangible assets, and in the management of related financial risks. Geographic reallocation and the shifting of activities between locations, as well as sophisticated financial instruments for shifting risks in ever-deeper global financial markets, have been instrumental in this multi-dimensional and never-ending search for efficiency called 'globalisation'. In fact, 'transnationalisation of production', 'transnationalisation of ownership', and 'transnationalisation of finance' appear as three faces of the same globalisation process. Financial and real globalisation progressed in parallel, complementing each other to a large extent.

"Geographic reallocation and the shifting of activities between locations, as well as sophisticated financial instruments for shifting risks in ever-deeper global financial markets, have been instrumental in this multi-dimensional and never-ending search for efficiency called 'globalisation'."

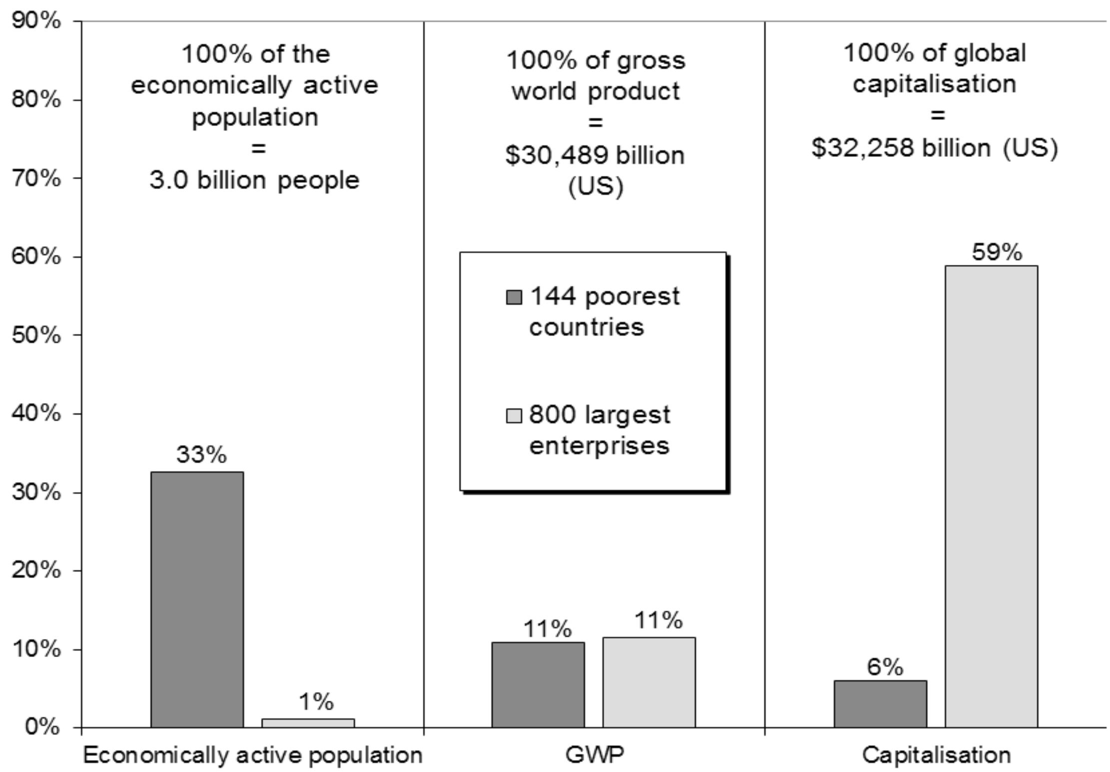
Macro-economic data on multinational enterprises as a group are lacking. Company reports (available only for listed enterprises) are therefore virtually the only accessible source of quantitative information about their size and role. According to our calculations, in 2010, the 800 largest listed non-financial enterprises had an aggregate turnover equal to one-third of GWP, while the turnover of the 1,500 largest amounted to 45% of GWP. These proportions did not change significantly since 2000. What does such a proportion mean? Total sales or turnover are primarily accounting figures. However they also have a macro-economic meaning. The turnover figure is the sum of two components—each very different from an economic point of view—1) the value of intermediate goods and services bought by these enterprises from their suppliers (about two-thirds of turnover in 2000); and 2) the amount of added value generated directly by them (about one-third in 2000). According to our estimates, the 800 largest non-industrial financial enterprises directly generated 11% of GWP and 22% indirectly, through their purchases. In order to fully capture the structuring influence this limited group of 'global giants' exerts on the global economy, a third item should be taken into account: the distribution costs necessary to bring their products and services to their final customers. These margins could well amount to another 20% of GWP. The structuring influence of the 800 largest non-financial enterprises (through supply chains, their own activity, and distribution chains) may amount to up to 50% of GWP. These figures however are only plausible orders of magnitude based on best estimates.

As shown in Figure 7, the 11% which the 800 giants add to GWP is roughly equivalent to the aggregate gross product of the 144 least developed countries in the world. While the 800 enterprises employed 30 million people worldwide, those 144 countries represented about 1 billion people, fully one-third of the world's active population. In other words, labour productivity in the largest corporations is about 30 times higher than the average productivity in the least developed countries.

According to convergent estimates, the loosely defined group of enterprises which can be called 'global giants' plays also a critical role in transnational investment and trade flows. Indeed, the bulk of direct foreign investments and of international trade flows (up to 80% according to recent UNCTAD estimates) involves a rather limited group of world class players.

In purely financial terms, the aggregate capitalisation of the same 800 enterprises amounted in 2000 to almost 60% of total global stock market capitalisation. This means that nearly two out of every three dollars invested in world stock markets are invested in shares of these companies. The same enterprises which have a structuring impact on 50% of GWP also make up 60% of global stock capitalisation. Is this a simple statistical coincidence or does it show convincingly that a limited group of 'global giants' play a critical role both in the transnationalisation of production and in the transnationalisation of finance? When the leaders of these companies gather in Davos every winter, they can rightly presume to represent critical force in the global economy.

Figure 7: Economic and financial weight of transnational enterprises[14]



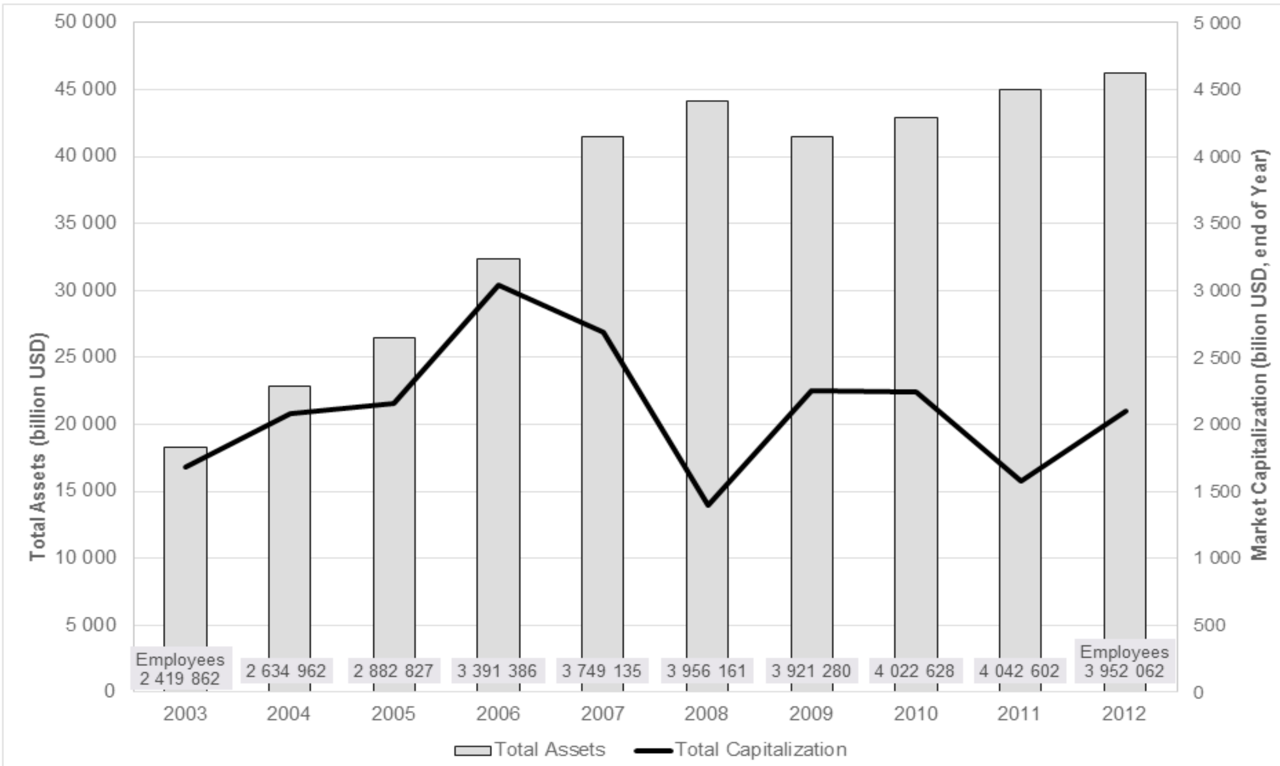
Transnationalisation of finance

After four decades of internationalisation of financial flows, finance is a transnational, global reality as much a national one. The global financial system is made of two very different layers. At the local level, a set of retail financial outfits (institutions or branches) act as 'last mile' collectors of savings and as distributors of financial products and services to private clients and small- and medium-sized enterprises. The corresponding flows are channelled and re-intermediated at a wholesale—often global—level and re-dispatched to the local outfits. In their matching activities (maturity, currency, levels of risk, asset classes) at the consolidated level, global financial institutions use sophisticated instruments and markets, normally only accessible to professionals (such as LIBOR markets). These few thousand non-financial 'global giants' are Very Important Clients for the global players of finance. These clients access the global financial services at the global—rather than local—level. There, the 'global giants' raise abundant and relatively cheap capital on global markets, they buy specialised services, carry out their M&A (mergers and acquisitions) activities, and manage their treasuries and cash balances.

Until the mid-1970s, financial activity was carried out mainly within national borders. Each country operated according to its own financial tradition in terms of financial assets, institutions, and regulations. Broadly speaking, national savings were used to fund national enterprises and investments. Challenges to these situations came progressively from three directions:

- The international expansion of enterprises by the multiplication of foreign affiliates. This trend, which started immediately after the war, allowed for financial resources (savings) accumulated in one internal market to be channelled via foreign direct investment flows into financing investment projects in another country. This demonstrates how trans-border financial and investment activity initiated by multinational enterprises shifts savings between different locations.
- Starting from the late 1960s, the number of foreign bank affiliates began to grow, especially in major financial centres. The consolidation and supervision of resulting multinational banks became increasingly demanding. After 2008, it has been recognised that these structures deserve special regulatory attention in terms of purpose, capital adequacy, and supervision. In 2011, for the first time, the Financial Stability Board has identified a limited number of transnational banks as 'Global Systemically Important Banks' (G-SIBs). Since then, the list is yearly updated. In November 2013, 29 banks were on the G-SIB list. They have been selected on the basis of their level of cross-jurisdictional activities, of their systemic interconnectedness, and of their overall complexity and size. Figure 8 provides some statistical information about this group of banks. Their combined balance sheets trebled in size between 2003 and 2007. Since the crisis, the total remained stable despite a differentiated evolution of the individual institutions.
- The financial landscape is made up not only of banks and insurance companies but also of non-regulated financial institutions with highly diversified activities. This so-called 'shadow finance' in the global financial system is difficult to measure precisely. According to BIS data, it amounts to 25% of total financial assets and to about 50% of the size of the classical banking sector.

Figure 8: Assets, employment, and market capitalisation of the 29 systemically important banks[15]



PART II
IST-ZUSTAND: WHAT DID THE EXPERIENCE DELIVER?

Part II has two aims: 1) to identify the salient characteristics of the present economic situation, particularly the role of financial activities; 2) to assess—in general terms and without specificity to country or region—if and to what extent the experience of Markets overpowering States has delivered upon its promises.

The dislocation of the Bretton Woods system as well as the subsequent evolution of the *modus operandi* of the world economy, were largely driven by the promises of the economic theory derived from neo-liberal premises regarding the natural selfishness of human beings and the natural character of markets. This quasi-ideological intellectual framework is very appealing, as it promises that a less regulated world will automatically generate increased efficiency, i.e. growing overall output.

The underlying and fundamental question is about the mutual relationship between higher efficiency and growth on one hand, and the corresponding side effects on the other hand: are these effects inescapable costs of growth, or is growth possible without them? In Part III, this trade-off and possible ways ahead will be discussed in light of the principles of Catholic Social Teaching.

The idealistic trap and ideological blindness

The risk and return paradigm and its corresponding worldview, discussed in Part I, derive from an intellectual—though not necessarily scientific—theory known as the '*efficient market hypothesis*' and, more broadly from the '*general equilibrium*' approach. The world described by the corresponding models has a built in self-organising force. Indeed, as long as States do not interfere in the natural functioning of markets, internal natural forces of interlocked and efficient markets are expected to drive the world spontaneously to ever higher degrees of efficiency by extending the grasp of markets to every possible good or service. This dynamic is at work until the system of markets is complete, i.e. until there is a proper market for every possible good or service.

Such a worldview has two important characteristics: first, any challenge to its underlying intellectual premises struggles to find a sufficient basis insofar as the worldview takes any critique based on observable reality and either discards or reinterprets it as a perfectible distortion of the ideal. The *efficient market hypothesis* is, in the Popperian sense, non-falsifiable. Second, such a worldview may easily inspire policies or a resistance to regulation more in line with idealism than with reality. Any policy based on simplistic assumptions may be counterproductive: this was the case in international finance with the general deregulation leading to the global crisis, as it was also the case with less sophisticated situations like the crises in German or Spanish savings banks. The recent crisis is but one more demonstration that fundamentalism—that is, blind idealism resistant to reality—leads to disruption or crisis over the medium or long term. This was the case with the collapse of Communist economies; this also was the case with the recent financial crisis.

We have many examples of idealistic models forging real financial decisions; one deserving of attention is the so-called '*Modigliani-Miller theorem*'[16]. This theorem encourages financial markets to disregard a company's capital structure—i.e. leverage or the debt-to-equity ratio—when assessing its market value. In other words, the share value of a company does not depend on the proportion of owned capital in its balance sheet. For decades, markets priced companies on the basis of Modigliani-Miller 'truth' while disregarding leverage. Only in 2007 and 2008—in light of the many major financial institutions on the brink of collapse—did it become evident that excessive leverage consistent with the *Modigliani-Miller theorem* was a threat to the world financial system.

Most economic and financial models, though aesthetically elegant, are rooted in idealism. Such models are often understood not as abstract exercises but as guides for how the world ought to be, while assuming that agents are 'perfectly informed' and 'rational'. The world of models describes the future not in terms of uncertainty but in terms of risk based in probability. In such a probabilistic environment, any action's consequences may be assessed, creating room for a 'rational' utilitarianism. Models are thus based both on the anthropological premise of natural selfishness and on the assumption that the future can be assessed. Rationality thereby comes down to utility maximisation.

In real life, however, the future is vastly unknown, shaped by actions based on incomplete information and even utter ignorance which often produce both unintended and unexpected effects. Thus may moral integrity become the compass, for when the consequences of one's actions are not known, rationality must instead attach to the moral quality of one's actions[17].

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When several main actors make decisions from model-driven rationality, it generates convergent behaviours, paradoxically turning models into reality in a kind of self-fulfilling prophecy. This works in periods of consensus and stability, as with the ideological capture and blindness to reality which prevailed during the years of 'roaring' financial globali sation. This may explain both the short-term successes and the depth of the crisis. In the field of economic thinking, the analogous blindness blocked imagination and allowed hubris to proliferate (*see* Figure 1).

Financial capital takes the lead

The development of financial markets discussed in Part I has had two important consequences: 1) it has strengthened the importance of financial signals in the daily management of listed enterprises; 2) it has turned the opinions of financial markets—via lending interest rates—into important factors influencing the economic and fiscal policy choices of many governments.

The risk and return paradigm has found its way into the internal management decisions of enterprises. Tying compensation of top management to share prices resulted in investment, placement, personnel, product development, and other decisions being based first on financial market considerations. This aligning of interests between management and shareholders was perfectly consistent with the '*shareholder value*' view of business, which at that time was growing in importance. This view holds that management's first duty is to maximise shareholder wealth as measured by stock prices rather than to care for the genuine interest of the enterprise itself. This is seen, for instance, in the preference of large enterprises for external growth through mergers and acquisitions over internal growth because it produces short-term financial results in the stock price, even though such transactions often fail in the medium to long term. The *shareholder value* revolution has destroyed the ontological coherence of listed enterprises, as all stakeholders become mere instruments for achieving shareholders' objectives[18].

"The shareholder value revolution has destroyed the ontological coherence of listed enterprises, as all stakeholders become mere instruments for achieving shareholders' objectives."

Financial valuations and opinions—built on 'expected' (i.e. desired) future performance—exert strong pressure on real-economy actors to meet the targets set for them by financial markets. There is an immense asymmetry between the distant and anonymous market's targets and the practical decisions needed to achieve these targets at the level of enterprises or public authorities. But an even more profound asymmetry has crept in alongside this: that between tangible reality (e.g. people, products, exchange) and virtual reality (e.g. spreadsheets of figures from analysts and managers). The crisis may be the point at which the pendulum swings back from virtual to tangible reality; the point where asymmetry may start to shrink.

Financialisation: The expansionist drive of finance

The very idea of efficient financial risk diversification presupposes the existence of different classes of assets with loosely—or even negatively—correlated returns. According to a widely-used hypothesis in financial modelling, correlation strength between different asset classes remains stable over time irrespective of the volume of speculative financial capital moving in and out of these investments. This hypothesis overlooks that when the volume of investments in an asset class greatly exceeds transactions related to the underlying activity, the correlation of the corresponding new asset class with other classes of assets automatically increases. When an exotic asset class becomes easier to access by speculative capital, the level of correlation with more traditional classes of assets rises along with it. When prices or correlation have reached a certain threshold, speculators may unexpectedly dump the asset class while taking it out of their portfolios. Such a sudden move may trigger a crisis and affect its real-economy operators—as happened during the 1997 Asian crisis.

The application of financial logic to any new asset class has two opposing effects: for speculators, it in theory increases diversification potential; for real-economy 'normal' users of the same asset class, however, the increased correlation exposes them to additional risks—e.g. price volatility—which they neither understand nor are able to cope with. Furthermore, one can argue that an asset class is of interest to speculators—motivated by risk and reward—precisely because others are using it without being 'infected' by financial reflexes. The surge of speculative capital into a given real-economy market thereby creates asymmetry between highly mobile speculators ready to leave the market without notice and real-economy buyers and sellers locked in this market.

"The surge of speculative capital into a given real-economy market thereby creates asymmetry between highly mobile speculators ready to leave the market without notice and real-economy buyers and sellers locked in this market."

Financing the present while inhibiting the future

External imbalances and deficits of all kinds did not disappear in the post-Bretton Woods era. On the contrary, they have blossomed. Neither flexible exchange rates nor mobility of portfolio capital have significantly contributed to facilitating a long-term rebalancing of the external positions of countries. Surprisingly, the post-Bretton Woods context—with its mix of 'flexible rates' and 'free capital flows'—has instead amplified global imbalances.

The years of euphoric financial globalisation clearly encouraged the accumulation of heavy long-term imbalances through the availability of abundant and relatively cheap credit, in spite of warning signs from local financial cracks or crises. This easy credit, together with liquid markets, affected the inter-temporal behaviour of all categories of actors: national and local governments, enterprises of all types and sizes, and households. Available credit made it possible to soften financial discipline and postpone otherwise necessary adjustments to 'better times'.

The inter-temporal budget constraints for government debt and for current account foreign indebtedness should in principle have provided a meaningful limit to the accumulation of imbalances, as the cost of non-adjustment was supposed to rise steadily. However, financial techniques gave the impression that unlimited 'roll-over' on debt was an option, allowing for the unlimited postponement of adjustment. In the midst of financial euphoria, basic principles of sane public finance seemed to have lost currency. Those principles re-emerged with full strength as the crisis became a reminder of the asymmetry inherent to debt relationships. While creditors can technically extend unlimited lines of credit—provided the overall risk of his position is kept under control—debtors facing increasing indebtedness must commit more and more future resources to servicing the debt, thus losing control of their future.

The asymmetric pressure on the debtor to adjust may start at the very moment creditors perceive a change in risk level. In such critical moments, optimistic sentiments, which sustain cross-border financing, abruptly turn to pessimism and financing dries up and becomes more expensive, often in a 'herd-like' manner. In an instant, as the mood of markets changes abruptly—as during the €uro debt crisis—small indebted countries come under sudden pressure to re-adjust their economies very quickly. This however does not apply to all countries. US imbalances tend to be tolerated for longer periods, leading to even larger imbalances, both because the whole world uses and is thus hostage to the dollar, and also because the US economy is able to generate valuable financial assets. In financial and monetary affairs, some countries are evidently 'more equal that the others'.

"The period of financial euphoria was in fact prone to increased indebtedness among all categories of real-economy actors. Household borrowing bet on rising real estate prices, enterprises bet on returns on investments, and governments simply borrowed and spent as the most convenient answer to social problems."

The period of financial euphoria was in fact prone to increased indebtedness among all categories of real-economy actors. Household borrowing bet on rising real estate prices, enterprises bet on returns on investments, and governments simply borrowed and spent as the most convenient answer to social problems. The mirror image of this trend is the increased overall volume of financing and related transactions. Consequently, total gross debt of all actors grew much faster than gross domestic products. Figures 9 and 10 illustrate the €uro-zone and the US situations. In both cases, between 2001 and 2010, the absolute increase in gross aggregate debt of all agents combined was 3.7 times higher than the increase in domestic product. In other words, for every €uro or dollar of value produced during that period, 3.7 €uros or dollars of additional debt were created. At least since the beginning of the century, these two economies depended on additional credit for their daily operations.

The basic asymmetry in any debt relationship is between the debtor inhibiting his future with debt to finance present day expenses or investment projects and the creditor risking his savings—or expression of past activities—for the sake of future revenues. The underlying asymmetry might well be between the urgency of present needs or opportunities and the search to secure the future with resources of the past. This asymmetry is further accentuated by the burden of interest which the debtor is obliged to pay in nearly all circumstances. The debt-related asymmetries in risk exposure pose a number of moral questions which have been abundantly debated in almost all spiritual traditions.

The sequence with which the 2007 crisis started is well known. It shows

Figure 9: Growth leveraged by debt—€uro-zone[19]

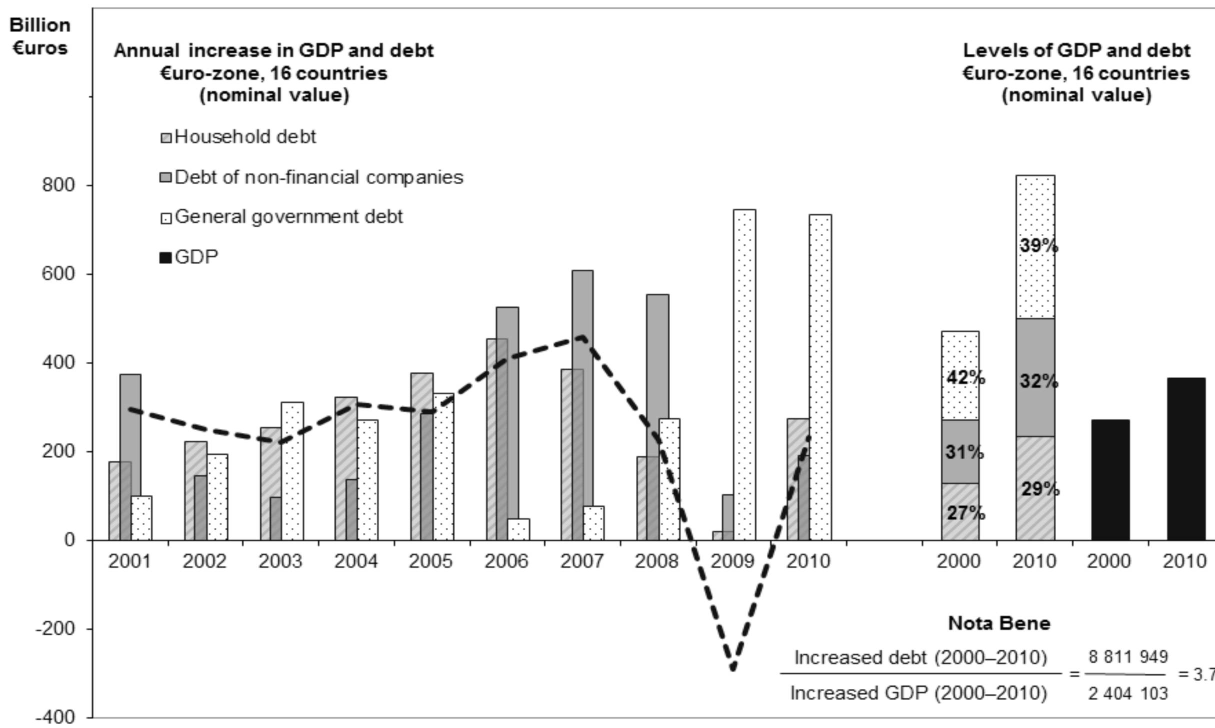
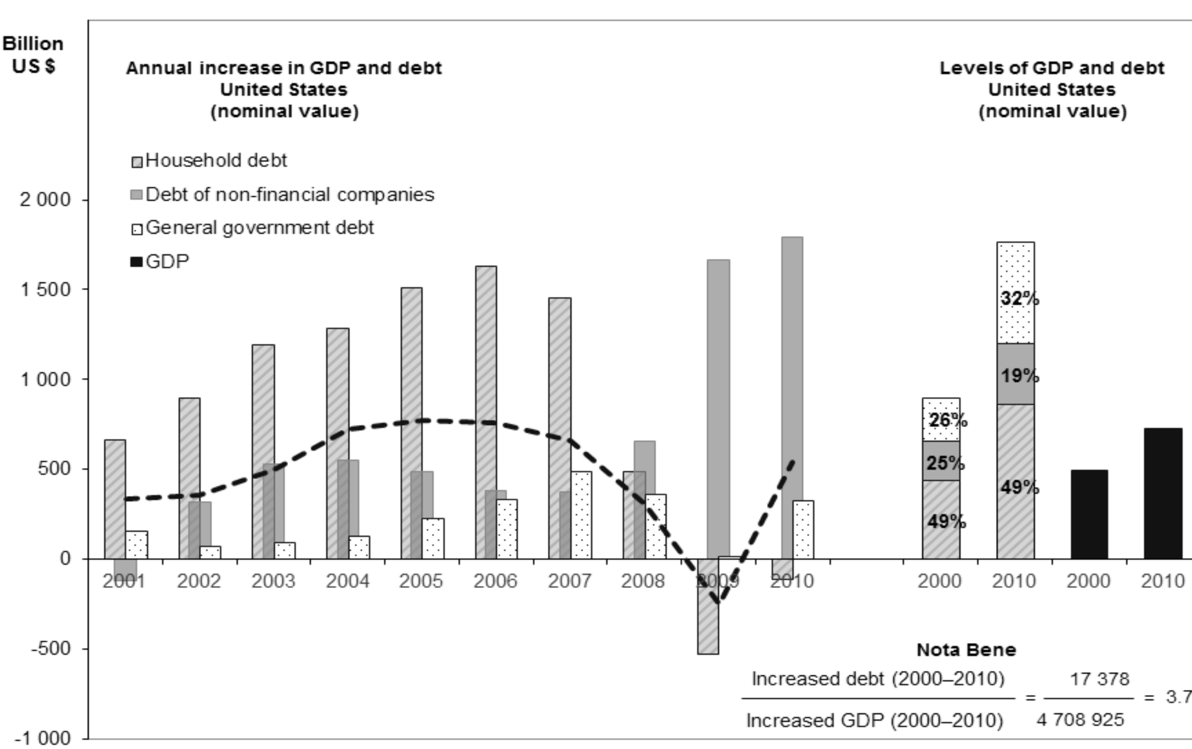


Figure 10: Growth leveraged by debt—United States[20]



that this asymmetry between lenders and borrowers may suffer exceptions. In the US the initial asymmetry between the individual lender and the mortgage borrower suddenly was reversed at the macro level. The society as a whole—i.e. taxpayers—had to rescue lenders because of the anticipated mass insolvency of borrowers. The reason why the taxpayers did step in was a fear of the overall collapse of financial systems spilling over to the whole economy. The world economy was under the threat of financial '*Weapons of Mass Destruction*'. One year later, the same sequence was at work in the €uro-zone: a financial system overexposed to over-indebted governments needed once again to be rescued by the taxpayers. In these two cases, central banks decided to flood the financial system with liquidity created *ex nihilo*. In both cases, public interventions by governments and central banks managed to preserve—at least temporarily—the supposedly intangible character of financial commitments. As a result of these interventions the pressure has—temporarily—been put back on borrowers.

Unregulated finance: Shadow banking and OTC markets

The expansion of international finance in the 1960s and 70s started in a regulatory vacuum. Financial innovations flourished in private dealings outside the reach of regulators. It took place under the auspices of the neo-liberal creed of non-interference and spontaneous market efficiency. The British 'Big Bang' of 1986—vastly deregulating financial services—is a symbolic example of this mood. Much of the expansion in financial activities thus happened without proper statistical tracking.

Until the late 1970s, most financial activities were carried out by two types of nationally regulated enterprises—retail banks and insurance companies—while investment banking was predominantly conducted in partnerships. Later on, innovative financial products and transactions started to be carried out either by non-bank and non-insurance companies, or by established institutions off-balance sheet. As such, these activities and companies were sheltered form the scrutiny of banking and insurance supervisors. The multiplication of off-balance sheet exposures, hedge funds, investment funds, and private equity funds is the most known dimension of this expansion. Only after the shock of 2008 did the G20 put in place the Financial Stability Board with the task of building a comprehensive picture of what is widely known today as 'shadow banking'. According to recent BIS/FSB estimates the combined balance sheet of shadow banking amounts to 50% of regulated banks' balance sheets[21].

For similar reasons, financial transactions have also been allowed to develop outside of the regulatory perimeter[22]. Because of its unregulated character, the LIBOR serving as an interest rate benchmark deserves some attention. The LIBOR (London Inter-Bank Offered Rate) has never been a proper 'market price' despite the fact that it is commonly used as a benchmark in pricing bonds. Technically speaking, LIBOR is a daily benchmark used by professionals as a mere reference point. To establish its daily level, a limited number of large banks report rates at which they think they could possibly borrow. By doing so they communicate an opinion rather than a fact of effective borrowing in which a rate is always related to a volume. Once the direct link between prices and volumes is severed—which is what happened with LIBOR—prices cease to be a 'reality check' and instead become fleeting information that can be inflated or deflated according to wishes and expectations. When used as a benchmark for price setting, information may lead to serious distortions. Imagine what would happen if a stock exchange were to price its shares simply by polling market players for opinions as to the appropriate price level of their respective shares, without reference to volumes and prices effectively traded. By ignoring the volumes effectively transacted, the LIBOR methodology contributed to bolstering the illusion of infinite liquidity available in financial markets—an illusion for which the world has been paying dearly ever since this liquidity evaporated in August 2007.

"By ignoring the volumes effectively transacted, the LIBOR methodology contributed to bolstering the illusion of infinite liquidity available in financial markets—an illusion for which the world has been paying dearly ever since this liquidity evaporated in August 2007."

LIBOR has become the crucial item of information for pricing almost $550 trillion US worth of assets around the globe. Through the technique of interest rate swap, LIBOR took on a significance that reflected both the banking sector's control over a significant part of the securities market and its belief that the ultimate method has been found for valuing financial assets so as to keep the operation profitable for banks and quasi-banks with access to the interbank market.

The very fact that the unclear LIBOR methodology was never subjected to proper scrutiny by regulators and totally left in the hands of private interests makes clear that monetary and financial authorities—British as well as international—deliberately failed to impose any additional scrutiny or constraint on the group of banks involved in LIBOR setting. Only today, when the rigging and wrongdoing has become evident, are banks being investigated and fined.

Many LIBOR related assets are held by unsophisticated clients of financial institutions, as well as by pension funds, insurance companies, and so on. If, as it now appears, LIBOR has knowingly been set several basis points above the real interbank lending rate—the rate at which banks actually transact among themselves—the likely impact on such clients is immense. Borrowers may well have been paying too much, lenders earning too much, and intermediaries enjoying too large of margins—and this may have been going on for decades.

The recent series of financial scandals shows that market discipline is not automatically imposed in the absence of supervision and regulation. For many advocates of *laissez-faire* non-intervention—such as Alan Greenspan—these scandals were a painful refutation. Indeed the long list of manipulations and wrong-doings—from structured products to LIBOR market rigging—suggests that the final users of these products have been the ultimate victims of this professional misconduct by individuals and institutions.

Pro qui bono? Deceived and disappointed users of financial products and services can rightly ask this question. The answer makes apparent another important asymmetry: the asymmetry between professional insiders and unsophisticated users. Regulation could have softened—but not prevented—all of the abuses by professionals which ethics and responsibility would have obliged against.

The development of financial activities was made possible because these techniques appeared to offer the promise of addressing two everlasting—almost eschatological—aspirations of mankind to earthly paradise. The first of them echoes directly the Biblical expulsion from the Garden and refers to the human aspiration to live without work. Indeed, financial techniques promise that properly managed financial capital can earn your living for you. The second one is the aspiration to security and stability. Risk management techniques carry with them the prospect of making the world a safe place to live. So, both a riskless world and a workless life may appear as if within reach, provided financial techniques are freed from regulatory burdens.

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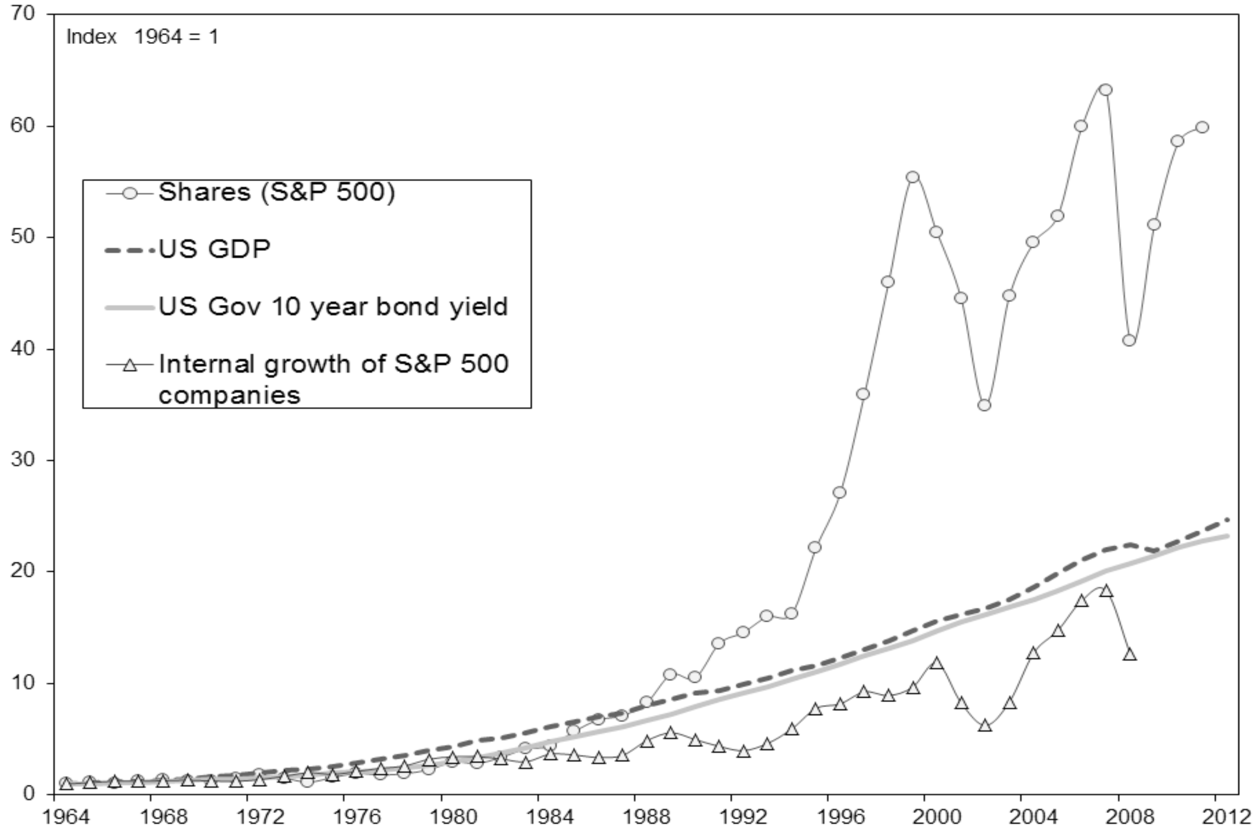
The outstanding, unfulfilled promises: The risk of losing systemic trust

During the first three decades of financial euphoria, financial returns were much higher than macro-economic growth and also higher that the economic performance of enterprises. Figure 11 shows the growing discrepancy between corporate performance, the compound rate of economic growth, and the compound rate of financial returns. Over nearly half a century, the US domestic product multiplied by 25 times, corporate bottom line performance by 14 (as of 2009), and compound returns on stock markets by 60. Between the mid-1980s and 2007, the financial music played for the ears of an ever richer, older Western population, more and more eager to secure its future material wellbeing. The financial sector, in its role as music band, was charming and dissuading of all fears, assisted in this task by the US central bank's policy of deliberately low interest rates.

By spending decades generating exuberant returns on stock markets—well over the growth rates of domestic product and public debt interest rates—financial techniques confirmed the impression that humanity had finally invented an income-generating '*perpetuum mobile*' where capital gains were able to pay for present expenses. Stock market returns on accumulated capital could thereby pay for decades of leisurely life. These implicitly provided the rationale for the establishment of largely demutualised capitalisation-based schemes for pensions, annuities, and life insurance in

Figure 11: Discrepancy between financial and real economic performance[23]



many developed countries. In parallel, scientific knowledge—largely based on models, accumulated and spread by professors of finance—reinforced the claim of professionals that risk management and diversification can significantly reduce the level of risk in the world.

The Western world took these promises seriously and people as well as enterprises entrusted to financial institutions a growing portion of responsibility for caring for their future. Trust was essential to this process: social trust in technical and scientific promises of finance, trust in institutions, and trust in the alchemic capacity of professionals to turn savings into permanent money-making devices.

After three decades of financial euphoria punctuated by only a few local and peripheral mini-crashes and crises, the very centre of the financial world tumbled in 2007. Suddenly the music stopped. Almost overnight the world discovered that its financial system was overburdened with debt and therefore much less robust than thought. All this has so suddenly happened not because the corresponding numbers were inflated overnight, but simply because the way of looking at these very figures changed overnight.

"Almost overnight the world discovered that its financial system was overburdened with debt and therefore much less robust than thought."

In reality, the risk and return paradigm is an inter-temporal approach extremely sensitive to the way the future is perceived. In times of optimism—if not outright euphoria—the future appears bright and is expected to pay for today's exuberance. On the other hand, in times of pessimism the future appears bleak and today's efforts have to pay for it. If the mood changes, so then does the perception of the future and of risk and its pricing. Such a mood change drives valuations down and the whole financial construct trembles and possibly falls apart. In the world of models—unlike in real life—behaviour is supposed to be rational (i.e. mood does not exist)—and therefore the classical financial construct is shockproof. Behavioural finance, a new trend in finance-related research, works closely with psychology and aims to understand and anticipate the reasons for irrational behaviours such as changes in mood. This research however is in early stages and is not able to offer yet an alternative to classical rational models.

In 2007, the igniting spark came from the residential US housing market. When prices stagnated, it provoked a dramatic rise in margin calls on collaterals, pushing many borrowers into difficulties leading to foreclosures. Consequently, the valuations of mortgage-related financial assets were radically revised; interbank lending stalled on fears of insolvency, trust and liquidity evaporated, and the interbank market ceased to operate. Liquidity—instrumental to flexibility and necessary for market forces to adapt and overcome any difficulty—suddenly stalled. The engine at the heart of world finance—geared to deliver maximum short-term efficiency out of permanent liquidity—was suffocating. The oxygen of financial markets is trust: trust in counterparties, but above all trust in promises.

After the 2008 collapse of Lehman Brothers, regulators discovered that risk was spreading everywhere, through ever tighter correlations between sophisticated securitised assets. The long-lasting trend of securitisation has removed risk form banks' balance sheets onto less visible assets—or structured products—traded mainly over-the-counter. From a 'solid-state form' on balance sheets, risk in securities markets became fluid and the danger was for it to become imperceptibly 'gaseous', impossible to detect and thereby endangering the whole economy.

In the face of a threat of total collapse, taxpayers were called in to bailout important components of the financial system with the hope that this would prevent the crisis from spilling over to the real economy. As a consequence, public finances—already in poor shape in many countries—became further strained by the rescue operations on one side, and on the other by expenses intended to maintain employment levels. The second wave of the crisis came when markets started to put sovereign debt under pressure, urging governments to restore public balances. This drastic revision of valuations had two consequences: putting pressure on those banks holding massive government debt and increasing borrowing costs for countries under scrutiny. At this stage, central banks were called to help, in one way or another, taking the distressed public debt out of the market. Central banks flooded the financial system with liquidity, preventing any significant financial collapse. These 'unconventional interventions' by central banks contributed to calm markets, but also to the diffusion of risk across all sectors of the economy and society.

What did the experience of unleashing the financial market deliver? It demonstrated that in finance—as in other segments of the economy—liberal self-regulation fails at maintaining a sane level of competition. The recent crisis also demonstrated that trust is both essential to financial activities and yet very fragile. When trust disappears, only public guarantees can bring life back to finance. The experience also may have demonstrated that trust may have been misplaced—that finance is not able to deliver on the eschatological promises for a risk-free and work-free life. Naïve trust, after years of illusion, has been upset by reality. In other words, the crisis has made apparent a dormant asymmetry or tension which is present in every society between eschatological aspirations to security and stability and the limited capacity of humanity to achieve it. In this respect, financial rationality, instruments, and techniques are no exception.

"The experience also may have demonstrated that trust may have been misplaced—that finance is not able to deliver on the eschatological promises for a risk-free and work-free life. Naïve trust, after years of illusion, has been upset by reality."

Systemic risk: Limits to regulation

In 2005, the total value of financial assets amounted to 4 times GWP, while in 1995, it was less than double. In 2005, the value of total financial transactions was 26 times GWP, while in 1995 is was 7 times. In this context of expanding finance, the outbreak of the financial crisis in 2007 endangered the whole world economy, which suddenly discovered that it was hostage to the financial system.

One of the least disputed lessons of the financial crisis is that 'systemic risk' not only exists, but really matters. Broadly defined, systemic risk appears when multiple interactions between a system's components create feed-back loops impossible to mastermind. Systemic risk is thus related to a system's level of complexity. It materialises when unsolved local problems are amplified and multiplied by an unchecked network of feed-back loops to the point of bringing the system to the verge of collapse. The financial crisis—spreading rapidly from one component to another—put the world economy in a situation risking near collapse.

The asymmetry underlying the very notion of systemic risk is obvious: a dysfunction rooted in an error or wrongdoing which may spill over and put at risk the survival of the whole. The financial crisis has stressed the asymmetry between, on one side, a sector employing less that 5% of the active population worldwide and generating not more than 10% of total product, and on the other side, the rest of the economy with all its human and social realities. The leverage of finance is due to the sheer volume of total financial assets or transactions in relation to GWP. This asymmetry is reminiscent of another asymmetry which became evident during a post-war era crisis: the oil shocks of the early 1970s, which showed the world the degree of its dependence on energy and oil.

Since the first meeting of the self-proclaimed 'World Board of Directors' in April 2009 in London, it was clear that the G20 had taken stock of systemic risk and was willing to prevent it from materialising. This is also acknowledged by the G20 meeting in late 2013. The St Petersburg declaration says:

> "We have agreed and are implementing a broad range of financial reforms to address the major fault lines that caused the crisis. We are building more resilient financial institutions, making substantial progress towards ending too-big-to-fail, increasing transparency and market integrity, filling regulatory gaps and addressing the risks from shadow banking. We will pursue our work to build a safe, reliable financial system responsive to the needs of our citizens."[24]

In its Annual Report of 2009, the Bank for International Settlements has clearly identified two requisite aspects of any effective attempts aimed at preventing the materialisation of a systemic crisis. First is reducing the level of complexity by extending regulation to the three components of the financial system—institutions, markets, and products; second is the introduction of a new level of 'macro-prudential' oversight and regulation. Macro-prudential regulation aims—in theory—to take into account the interactions between the system's components, rather than merely components themselves, which is already the aim of micro-regulation.

The well-known 'Basel' rules on capital adequacy are a good case in point: the first two generations of these rules—Basel I (1988) and Basel II (2010)—were clearly micro-prudential. They aimed at strengthening the shock-absorbing capacity of individual institutions by imposing capital buffers into balance sheets. Today, the situation with Basel III is different, as its requirements differ with the degree of systemic importance of the institution concerned. That being said, mitigating systemic risk involves much more than Basel III alone. In its Annual Report of 2009, the Bank for International Settlements proposed an agenda in line with the challenge:

> "Ensuring financial stability requires a redesign of macroeconomic as well as regulatory and supervisory policies with an eye to mitigating systemic risks."[25]

The identification of systemic risk as a specific and serious category of risk sheds new light on the old relationship between efficiency and complexity. In the pre-crisis decades, increasing complexity was interpreted in terms of progressing marketisation and linked with expected efficiency gains, while the down-side of this process, namely the piling up of systemic risk, continued unnoticed. How to explain this long-lasting misperception of reality? Undoubtedly, one of the reasons lies in the prevailing fascination with idealistic promises and the idea of the natural multiplication of markets—and the subsequent disregard for reality checks. Today, the perceptions are changing and systemic risk appears to many to be a consequence of increased complexity. In consequence, the critical question to be kept in mind concerns the level of acceptable trade-off between efficiency gains promised by a non-regulated market system and increased systemic risk. There might be a point when returns on additional complexity are lower that the controls such complexity implies. At this point, even from an economic perspective, complexity would have reached the zone of negative returns. It is not impossible that the complexity of finance is pushing the world into uncharted waters of negative risk-weighted returns on complexity.

Limited transfer of resources to developing countries

Efficient international financial markets were supposed to allocate savings to the best investment opportunities. If so, low income countries—supposedly opportunity-rich and savings-poor—were expected to attract financial resources from high income countries—supposedly opportunity-poor and savings-rich—and use them so as to promote internal growth. The previous discussion of imbalances has already shown that, broadly speaking, this was not the case, as deficit countries were de facto paying for their imports with their assets then being stored in the vaults of surplus countries' central banks. This broad picture however was too general to capture non-trade related resource flows to what the World Bank calls 'developing countries' (*see* Figure 12). While China and Russia are included by the World Bank as 'developing countries', they have been excluded from the analysis here because they are important parts of the broad picture of these imbalances.

The structure of this table departs on three main points from the classical presentation of North-South financial flows:

- Profit remittances (on foreign investments) by transnational corporations are included here even if technically they are part of the current—not capital—account of the balance of payments. These amounts have to be taken into account as they are the remuneration of foreign capital invested within the country;
- Migrants' remittances to home countries also are taken into account here because, again, these amounts correspond to unilateral transfers of savings. As profit remittances, from the accounting point of view they are part of the current account;
- A theoretical 'net position' has been calculated by subtracting the level of international reserves from total outstanding international debt. These reserves usually belong to central banks and are either held in

cash or, more often, invested in financial assets denominated in foreign currency.

Thanks to these adjustments, Figure 12 provides a comprehensive picture of transfers of savings and assets and of related payments from and to developing countries, although the situation of individual countries or regions might differ from the aggregate picture. Figure 12 also gives an idea of the North-South net financial positions. The numbers in this table deserve a few comments:

- The overall external gross debt of the developing world has been consistently growing and today reaches about $3 trillion US—4% of GWP. That being said, the overall net position of these countries—taking into account their international reserves—is a surplus of about $1 trillion US. In absolute terms, this figure is close to 30% of their total external indebtedness.
- Since 2000, the net inflow of non-debt resources to developing countries has been growing to reach about $350 billion US in 2010. However, it is worth stressing that migrants' remittances make up more than two thirds of this amount.
- Investment flows (FDI) cumulated since 2005 are slightly higher than net debt inflows over the same period. However, as the existing FDI stocks generate substantial returns, amounts of profits which are re-exported to corporate headquarters have to be subtracted in order to obtain a net investment inflow position. The net inflow of FDI is about 70% lower than the gross inflow usually presented in international statistics.
- The aggregate position of 'low income countries'—the group of 32 mainly sub-Saharan countries with a 2010 per capita income below $1,005 US—is drastically different. Total debt amounts to $111 billion US, which corresponds to more than 25% of their aggregate product and is almost entirely attributable to public bodies of the developed world. These countries manage to raise each year $5–10 billion US in net debt while they receive at least double this amount in remittances.
- N.B.: according to OECD data, in 2012, total disbursements of official development aid from all sources amounted to $126 billion US. This amount corresponds roughly to 50% of remittances and to slightly less than 0.3% of donor countries' national income. These flows do not appear in Figure 12.

Figure 12 is based on official data which do not include improperly reported flows, i.e. corruption related flows or payments for exported raw materials which never reach the exporting country. The amounts deposited in financial centres and 'belonging' to elites in developing countries may

Figure 12: Financial flows to and from developing countries, excluding trade-related payments and official development aid flows (in $ billions US)[26]

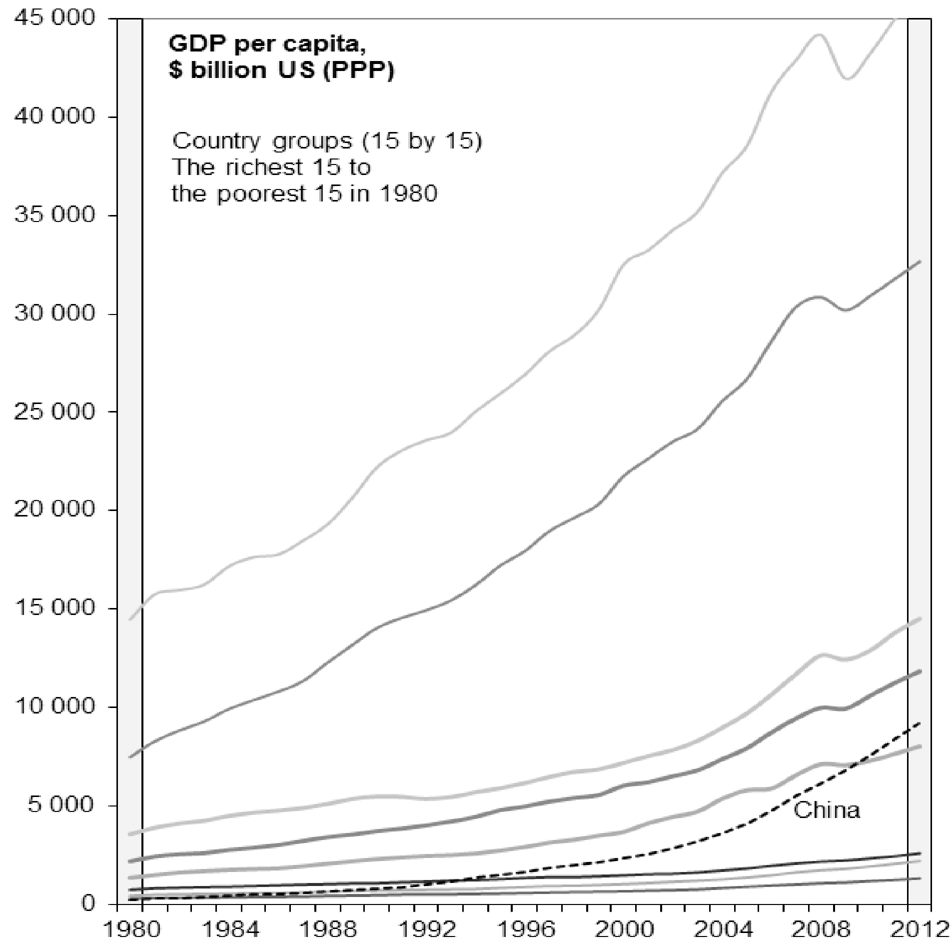
	All developing countries, without China & Russia	1995	2000	2005	2006	2007	2008	2009	2010
A	Net debt inflows	120	4	74	129	316	220	142	360
B	Outflow of interest payments on debt	76	100	88	95	110	111	101	103
C	Inflow of FDI (foreign direct investment)	57	108	184	234	319	374	249	278
D	Outflow of profit remittances on FDI	27	47	129	173	221	243	191	191
E	Inflow of portfolio equity investments	13	7	47	58	96	-47	77	102
F	Inflow of workers remittances	50	71	160	190	233	268	252	263
G	International reserves (end of year)	341	443	965	1 231	1 676	1 761	1 943	2 195
H	Total external indebtedness (end of year)	1 621	1 821	1 992	2 102	2 486	2 717	2 834	3 143
	Net liabilities (H-G)	1 280	1 378	1 026	870	810	955	891	948
1	Non-debt inflows (F+E+C)	120	186	391	482	648	595	579	643
2	Non-debt outflows (B+D)	103	147	217	268	331	354	292	294
	Net-non-debt flows (1-2)	17	39	174	215	317	241	286	349

well offset the total net indebtedness of these countries, but their precise assessment is, for technical reasons, impossible[27].

According to various estimates[28], FDI flows related to transnational production networks are concentrated in a handful of 'emerging' countries (such as the BRICS), which means that a number of developing countries—among the poorest—remain outside of the processes of transnational production. Indeed, FDI inflows to developing countries others than BRICS amounted to $74 billion US while the outgoing profit remittances amounted to $46 billion US. This shows the limits of the inclusive role of transnational networks of production. On the consumption side however, products and services of 'global giants' are imported globally and reach the most remote places on Earth. Thus there is an important asymmetry between the narrow inclusive reach of production networks that may help generate export proceeds for countries and the much wider reach of imported products which generates expenses.

Parallel to the $28 billion US in net foreign investment, these same groups of non-BRICS countries were receiving $83 billion US in portfolio investment flows. These flows are purely speculative and highly volatile as they chase de-correlated assets in order to hedge global risks. They bring volatility to weak local financial markets and speculative revenues to a limited local elite; they foster the expansion of the local financial sector but have a very limited positive impact on the local enterprises listed on stock exchanges. Portfolio flows do not mitigate the asymmetry in terms of access to stable investment funding between the global giants and the local enterprises in the developing world. As for the flow of remittances—which are above all 'love flows' and which for non-BRICS developing countries

Figure 13: Absolute change in GDP per capita (PPP)[29]

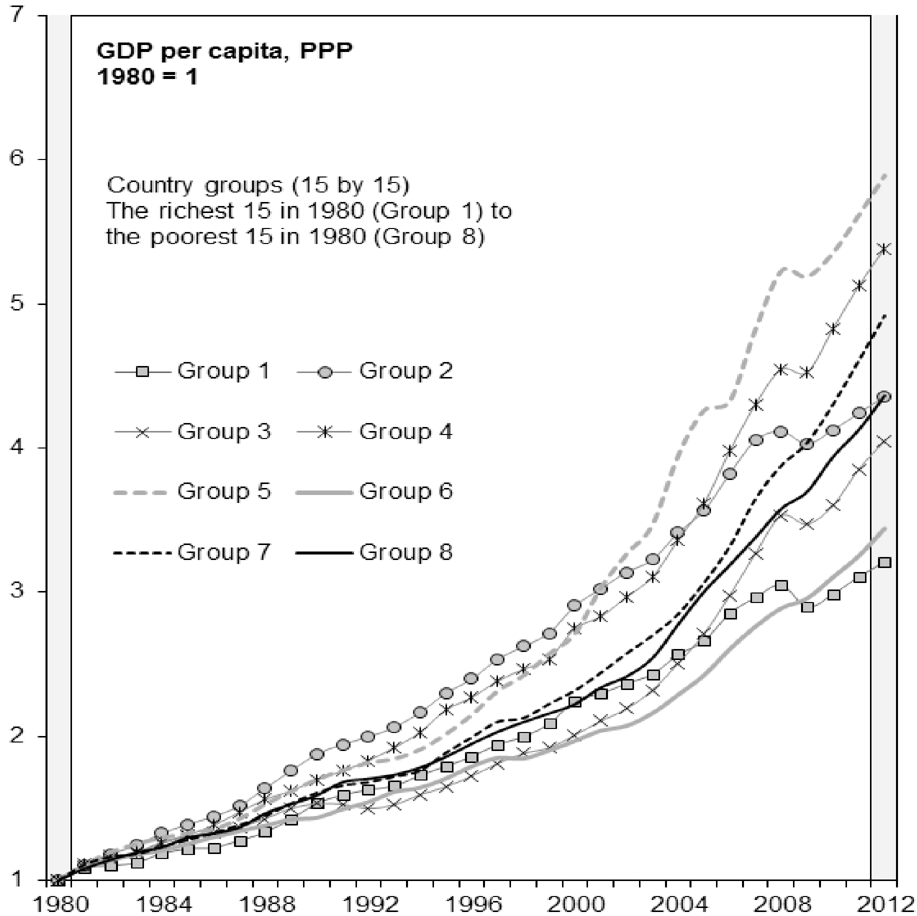


amount to $59 billion US per year—they only marginally reach enterprises.

Unprecedented growth with inequalities

In purely economic terms, the unleashing of market forces undoubtedly did deliver. It delivered three decades of uneven but relatively high aggregate growth: according to OECD calculations, between 1975 and 2010 GWP rose in real terms 3.1 times (1975 = 100); the corresponding growth in so-called advanced countries was 2.5 and that of emerging ones was 4.7. When expressed in per capita terms which account for different demographic dynamics, growth is slightly higher for the advanced economies and lower for emerging ones. These average figures even out very different economic dynamics of countries and regions which are depicted in Figures 13 and 14. Despite the dynamic variety of situations, however, low-income countries are not significantly catching up in terms of PPP (purchasing power parity) per capita. In other words, the growth differ-

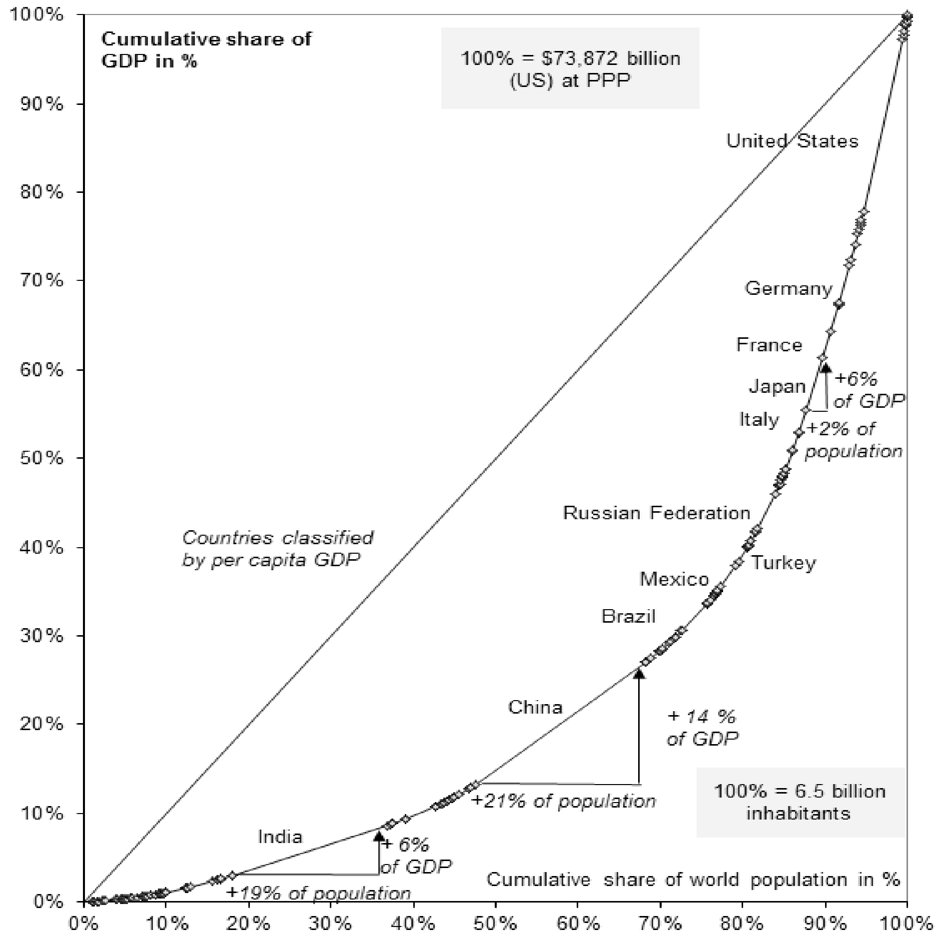
Figure 14: Changes in GDP per capita (PPP)[30]



ential between advanced and emerging economies in PPP per capita has not been sufficient to significantly contribute to a convergence of average absolute income levels across the globe[31].

The overall picture of how global added-value—i.e. gross world product—is produced and consumed across the globe changed only slightly between 2000 and 2010. A simplified, tentative Lorenz curve is presented in Figure 15. It takes into account the average per capita income across countries and thus ignores their internal inequalities. The horizontal axis depicts total world population in a sequence of segments, each corresponding to the population of one country. The segments are ordered starting on the left with lowest to highest PPP per capita. The vertical axis represents the total GWP segmented into contributions of each country ordered bottom to top, as they appear on the horizontal axis. The resulting curve can also be viewed as a succession of stacked triangles, one per country. The base of each triangle corresponds to that country's share of world population; the height to its share of GWP. For instance, China generates 14% of GWP and has 21% of population.

Figure 15: International Lorenz Curve 2010 (PPP)[32]



In aggregate terms, in 2010 as in 2000, the poorest 40% of world population produced and consumed about 10% of world income, while, at the other end of the pyramid, 40% of world income was generated and consumed by the richest 10% of the population. Between these extremes, 50% of income is shared in unevenly distributed proportions by 50% of world population. This way of looking at the distribution of world income ignores internal inequalities which—according to many sources—have been expanding. On top of this, inequalities between countries would appear even greater if nominal income data, not PPP, were used[33].

Deepening and expanding asymmetries

The analysis presented in Parts I and II of this paper has exposed a number of asymmetries that have deepened during the decades of financial euphoria. The list below summarises these findings by classifying these asymmetries by their underlying dimension.

Asymmetries of power

- Asymmetry between the reach and scope of political regulations and the realm of private economic expansion: the collapse of inter-state agreements in the field of foreign exchange regulation and their absence regarding the flows of capital made the world wide open for the international expansion of private actors. By the same token, exchange risk has been demutualised, leaving some actors less prepared to cope with it.
- Asymmetry between the regulated and unregulated components of the financial universe: the collapse of the Bretton Woods system has set the stage for the development of financial markets and institutions outside the regulatory perimeter. This uneven treatment created deep asymmetries between regulated and non-regulated financial actors and was one of the factors which amplified systemic risk.

Size matters: Asymmetries between actors

- Asymmetry in the size and transnational reach of enterprises: the possibilities of transnational expansion have been grasped by a limited number of corporations. Today these 'global giants' are the backbone of the transnational economy, and as such they are able to structure and organise the work of tens of thousands of their suppliers and distributors.
- Asymmetry in legal and market power between the physical economic agent (employee or customer) and the 'global giants' as moral persons. The asymmetry relates not only to size but to the ontological nature of these two types of 'persons', which size only reinforces.
- Asymmetry between countries that are net exporters or net importers of financial assets. In the last decades the expected massive transfer of financial resources from the North to the South did not take place, with the bulk of foreign direct investment being concentrated on a very limited number of countries.

Asymmetries between capital and the real economy

- Asymmetry between capital and labour: the autonomisation of financial capital, further reinforced by the dominance of the shareholder value approach to management, has fundamentally changed the relationship between labour and capital within enterprises. Consequently, return on capital (financial efficiency) has gained overall pre-eminence, with labour, clients, and suppliers being more often than not the adjustment variable.
- Asymmetry between the real economy and social constraints and their financial and virtual mirror image: financial considerations and ex-

pectations—intermediated by financial markets—have gained the upper hand in setting the targets for listed corporations (and their value chains) as well as for public bodies.

Asymmetries in access

- Asymmetry in the distribution of income: during recent decades, inequalities in income distribution have diminished neither internationally nor nationally to any significant extent.
- Asymmetry in magnitude between the daily needs of 40% of the world population and the volumes and values of financial transactions and assets. The poorest 40% of the world lives roughly with 10% of GWP, while the approximate value of total financial assets is 40 times higher; the annual turnover on forex markets is 230 times higher; the value of outstanding derivatives is 120 times higher; and the balance sheet of the 29 systemically important banks is 10 times higher. These figures give an idea about economic and financial disparities between the 'the financial capitals' of the world and the distant periphery.
- Asymmetry in understanding the intricacies of financial innovation: weak or absent regulation was instrumental in the explosion of financial innovation which in many respects was never properly understood by the end-users.
- Asymmetries tantamount to moral hazard or free riding. In these situations the short-term benefit for one player is said to rationally justify behaviours that are detrimental to the group. This is what happens when systemic risk materialises as a consequence of free riding by some players.

The preceding pages suggest that the unleashing of markets discussed in Part I has had two effects: on one side the aggregate growth of world output; on the other, the building up and deepening of several asymmetries. This list is but a survey and could easily be extended. This situation poses two important questions: 1) on a general and systemic level, given the intricate relationship between the two realities of aggregate growth and deepening asymmetries, whether the deepening of asymmetries is an inescapable consequence—or even the engine—of economic growth; and 2) on a more practical level, largely independent from the first question, what ought the Christian attitude be towards these so-called asymmetries.

Throughout the sections of technical analysis, the word 'asymmetry' has been systematically preferred to other value-loaded terms such as 'injustice' in order to avoid implicit value judgments. In its broad sense, 'asymmetry' means a lack of harmony, a lack of balance, a lack of proportionality, or even possibly a lack of justice. That being said, the Christian perspective and recipe for action must go beyond the aesthetic considerations of 'asymmetry' and involve the dimension of justice and take action needed to restore or support it. The concern for justice has pre-eminence over the general considerations about the relationship between asymmetries and economic growth simply because overall efficiency ought not to be seen as a morally acceptable justification for a lack of justice. Indeed, as it has been ceaselessly repeated by Catholic Social Teaching, economic activity has to serve the human person and society, not the other way around. In consequence, Common Good and integral human development have pre-eminence over efficiency. When asymmetries challenge basic requirements of justice and of social harmony they require informed corrective action respectful of the Common Good.

The aim of Part III is to replace the technical diagnosis of asymmetries into a broader context of Catholic Social Teaching, and more precisely in the perspective of its core notion, the notion of the Common Good. This perspective will shed light on possible avenues and methods for action.

Part III
A CHRISTIAN PERSEPCTIVE: THE CHALLENGE OF ASYMMETRIES

Is not this the fast that I choose:
to loose the bonds of injustice,
to undo the thongs of the yoke,
to let the oppressed go free,
and to break every yoke?
Is it not to share your bread with the hungry,
and bring the homeless poor into your house;
when you see the naked, to cover them,
and not to hide yourself from your own kin?
Isaiah 58:6–7

❡ *Introduction*

Parts I and II have shown that increased efficiency has undoubtedly contributed to overall economic performance in the 'Age of Euphoric Finance'. However, the same pages also show that these unprecedented achievements were accompanied by deepening asymmetries. Many of the encountered asymmetries seem to overlap more often than compensate for each other. Therefore, the chances of being on the weak side of one asymmetry correlates strongly with (and probably also depends on) the fact of being in the same situation in respect of other lines of symmetry. In such cases, the multiple asymmetries would combine into one unique multi-dimensional reality. The fact that many of these asymmetries overlap simply indicates that the weak are at the same time the poor, the vulnerable, and the excluded.

The multidimensional character of weaknesses, vulnerability, and poverty of these same persons, enterprises, or regions would therefore appear today to be systemic[34]. If the systemic diagnosis is correct, it implies that possible remedies must also be systemic, i.e. not only multi-level and multi-actor but also coherent. The Christian perspective offers a sufficient framework for designing such a multi-faceted, coherent action.

"Does the deepening of asymmetries belong to accidental consequences of increased economic efficiency and overall prosperity, or are they rather inescapable consequences stemming from the very 'logic of the system'?"

The question of how these asymmetries can and should be addressed depends on the answer to another question: does the deepening of asymmetries in general, and in particular those described herein, belong to accidental consequences of increased economic efficiency and overall prosperity, or are they rather inescapable consequences stemming from the very 'logic of the system'? Forty years ago, Arthur Okun put his finger on the trade-off between *efficiency* and *equality* which he thought of as being an inescapable one. Was Okun right? Is the world today facing an either/or alternative without any room to manoeuvre? Or are there possibilities not only to mitigate or contain asymmetries but drastically to reduce them without destroying the efficiency-driven engine of economic growth? If the latter is true, what criteria should be used to assess the acceptable and realistic trade-offs? And more fundamentally, are trade-offs between values (such as equity) and tools (such as efficiency) acceptable to Christians[35]?

"Is the world today facing an either/or alternative without any room to manoeuvre? Or are there possibilities not only to mitigate or contain asymmetries but drastically to reduce them without destroying the efficiency-driven engine of economic growth?"

Part III looks at the 'systemic conundrum of asymmetries and inequities' as a challenge confronting the present world. Catholic Social Teaching (CST) may provide an inspiration and a compass for action addressing this challenge. Part III has two sections. In the first section, two different ways of approaching asymmetries are contrasted and discussed: The 'efficient equilibrium' perspective *versus* the 'Common Good' perspective. The second section identifies some avenues for action to address the systemic causes of asymmetries.

Efficient equilibrium vs. the Common Good

¶ Efficiency and efficient equilibrium

Efficiency is the key driver of economic and managerial rationality. This notion is currently used on the macro-economic as well as micro-economic levels; in both cases it refers to resources used in achieving results.

On the micro-economic level, efficiency is closely related to productivity. While productivity focuses on the contribution of one factor of production to the overall result, efficiency has a broader meaning. It refers to the way—often called the rational way—all resources are used so as to achieve more with the same, or, conversely, the same with less. The reference point of micro-economic efficiency is the internal working of the firm[36].

The ultimate goal in all teaching and efforts in modern management is the achievement of the highest possible level of efficiency. From the managerial perspective, technical efficiency is instrumental for achieving economic and financial efficiency. In fact, in all enterprises around the world, more or less successful efforts are carried out on two fronts: 1) on the production side to minimise the total unitary costs of output and the amount of financial capital used; and 2) on the distribution side, to maximise receipts for each and every unit sold. In order to achieve this, on the production side, the contribution of each and every input is assessed and determined individually and its remuneration agreed accordingly. A parallel effort takes place on the sales side, where the willingness of every potential client to pay is scrutinised by sophisticated marketing tools. This overall drive for efficiency in any individual firm is however constrained by external elements such as the level of market competition. The stronger the competition, the smaller the margins to manoeuvre for individual firms in terms of input costs and output prices. In the ideal world of economic theory, in which perfect market competition sets the reference, paradoxically no margin of manoeuvre is left to the management of the individual firm as inputs are priced across the economy at their marginal productivity, technology is common, and homogenous outputs are sold at one unique 'market clearing' price. In this ideal world, therefore, allocative efficiency prevails as firms are forced by markets either to attain the highest possible level of internal technical efficiency or to exit.

On the macro-economic level, the notion of efficiency refers either to the *allocative efficiency* realised by markets, or to the so-called *Pareto efficiency* and the subsequent income distribution. Allocative efficiency focuses on the way available resources (including labour and capital) are allocated to different productions. Macro-economic allocation is meant to be optimal or fully efficient only in model-type situations of perfect competition. Under these conditions, the economy produces only those goods and services that are of highest importance to customers. The absence of externalities—i.e. external effects which are not accounted for in the market price—is a necessary, though highly unrealistic, condition for a successful fully efficient or optimal allocation.

The name Vilfredo Pareto (1848–1923) is associated with the notion of *income distribution efficiency*. Within the neo-classical world of models, a given distribution is optimal or *Pareto-efficient* when one person cannot be made better-off without making someone else worse off[37]. In an ideal world, there are only those who at the same time produce and consume. In a situation of efficiency, each of them receives an income which is strictly equal to his or her contribution to the overall production effort. Everyone is entitled to use these revenues to maximise his or her preferences by putting price-tags on goods and this, in turn, drives production. As the actors are supposed to be self-interested, by the same token the situation of *allocative* and *Pareto efficiency* coincides with social optimum or the so-called *general interest*.

"This concise and very elegant theory lies at the very root of the neo-liberal worldview which ... states as an act of faith that as state regulation decreases, the degree of competition increases, which in turn implies higher efficiency and a higher degree of realisation of the general interest."

This concise and very elegant theory lies at the very root of the neo-liberal worldview which has inspired the recent unleashing of market forces. The corresponding political rationality, derived from theory by the way of many simplifications and inconsistencies, states as an act of faith that as state regulation decreases, the degree of competition increases, which in turn implies higher efficiency and a higher degree of realisation of the general interest.

❡ *General interest*

The notion of 'interest' plays a key role in contemporary economic theorising. For the still-dominant economic theory, general interest is the aggregation of individual—self-centred—interests. Without entering into technicalities, the accepted rules of aggregation will determine where general interest lies. Are individual interests personal or can one consider a common denominator such as a 'representative' individual? Must individual interests be considered in an order of preferences—as meant by Pareto himself—thereby making aggregation and numerical comparisons impossible? Or can individual interests be expressed in numerical form? And if so, to what extent can the gains of some even out the losses of others? These questions have never received a final response. They were discussed for centuries by moralists, political philosophers, and scientists. Surprisingly however, the fact that these debates are still open has little bearing on economic theory, which fosters general interest as an arithmetic aggregation of individual ones by its unique recommendation—greater efficiency by way of increased competition.

Among the finest intellectual achievements of the still-dominant neo-classical theory are 'general equilibrium models' which consider jointly the two sides of economic activity: production and consumption. These models formally confirm that if markets are perfect and driven exclusively by rational self-interest, they will deliver maximum efficiency and the highest possible level of satisfaction of the 'general interest'. These ideal considerations are behind the ideological and simplified political vision which may be termed the '*Ideality-inspired Efficient Equilibrium*' (IEE) view and which has inspired many economic policy choices during the last decades.

Summing up, the justification of unbridled economic rationality derives its moral strength from the promise that private interests drive efficiency and pave the way for the better fulfilment of the general interest. Despite its elegance and formal appeal, IEE rests on five major limitations or ambiguities:

- By design, the general interest is the aggregation of interests of only those who take part in productive activity. Thus, about half of the population is left outside of the scope of the narrowly defined general interest;
- Efficient equilibrium rests on the idea that the income of each agent is strictly equal to its productive contribution. This supposes that such contribution can be established beyond any doubt.
- General interest—and the related efficient or optimal solution or equilibrium—is the outcome of the aggregation in which the losses of some may be more than off-set by the gains of others. In such calculations the absolute level of gains and losses is taken into account irrespective of their relative weight on the situation of those affected. While it is obvious that losing or gaining one unit does not have the same meaning when one has 10 or 10,000 of such units, the two situations are treated equally in this paradigm.
- Ultimately, any general interest or efficient equilibrium related calculation is based on pure exchange transactions using monetary equivalents. The underlying assumption is that all of human life and concerns can be expressed exclusively in terms of monetary gains, losses, and possible compensations.

- The notion of general interest present in economic theory is deeply different from the 'general interest' as conceived by Jean-Jacques Rousseau and his followers. For Rousseau, citizens intuitively recognise where the public good (or interest) lies and are able to surrender to it when the public interest and their own private interests diverge. This shows that the general interest of Rousseau is based on a pledge about the universality of an abstract, public good-centred, enlightened citizen which has little to do with the self-centred, rational, and private satisfaction-maximising individual conceived of by economic theory.

¶ The shortcomings of efficient equilibrium and general interest

In the narrowly idealised world, increased output—i.e. efficiency—may well be achieved by way of deeper asymmetries. Indeed, a widening productivity gap and the corresponding widening income gaps between individuals as well as between countries may well be instrumental in increasing overall, aggregate output, making the whole more efficient. Such a situation is fully compatible with classical models of pure international trade theory, which show that free trade increases overall production, but which are silent about how these gains split among trading partners. Furthermore, model-related efficiency can ideally be achieved despite the fact that unproductive members of society are simply ignored or even discarded, which theoretically means they are deprived of their subsistence.

Another weakness of these models is the fact that they are static. They are not able to explain which internal mechanism can drive the world from a situation with low competition to one with increased competition, and how the promised effects of diminishing inequalities or more inclusive growth can be achieved[38]. In other words, where competition is low, no internal market force is able to eradicate monopolistic or oligopolistic rents and increase the level of competition. The converse however is not true, as perverse dynamics of growing rents derived from proprietary assets, externalities, dominant market positions, or dominant roles within enterprises together with underlying power relations are sources of potential self-deepening distortions. This vicious cycle of 'distortions-rents' may further reinforce asymmetries and inequalities of all kinds, especially between enterprises, and between factors of production.

In the real world where competition is far from perfect and where externalities flourish, the fact that a built-in automatic mechanism geared to greater efficiency is missing in the general construct of the market economy is even more problematic. In many real situations power relations, rents, and distortions subsist without state intervention, as suggested by the empirical insights presented in Parts I and II. Despite significant evidence that markets do not automatically tend to perfect competition, for the neo-liberal mantra, the only prudent way of combating rents and distortions is to further increase the room left to private economic rationality.

Another practical weakness of the IEE approach is its inability to deal with inter-temporal choices which involve uncertainty. Financial techniques domesticate—and pervert—uncertainty by limiting the scope of possible events and by assigning corresponding probabilities. In such a closed probabilistic world, risk and corresponding hedging techniques, discount rates, and risk premiums seem prudent. They allow for extending the limits of IEE models to inter-temporal situations by way of the *Efficient Market Hypothesis*. In the real world, however, as the crisis has reminded us, probabilistic risk management techniques do not suffice for providing firm ground for fully rational inter-temporal calculations. For this reason, IEE is essentially merely a static concept.

¶ The Common Good

The notion of the 'Common Good' is central to Catholic Social Teaching. All its principles—solidarity, subsidiarity, the preferential option for the poor, the prominence of labour over capital, and so on—are in fact markers on the roads converging towards the Common Good. None of these principles are self-sufficient; they complement and reinforce each other and combine into the highest common good, which is ultimately the unity of all in God. The following quotations help to capture the meaning of this concept which has a long-standing presence in Christian philosophy and against which modern concepts of general interest (both economic theory and the Rousseau-inspired political theory) were erected between the 16th and 19th centuries:

> "The common good is not the good of the abstract collective or the state, nor is it merely the amalgamation of goods of individual members, but rather the good of every person both as an individual and as a social being in relation to others. … The common good does not exist only on the level of state or nation, however, but at the level of every human group or community. Thus we can speak of common good of families of associations, local communities, the Church, states, nations and of any other human group that fall somewhere in between. Moreover, along with the *particular* common good of these different human groups, we can also recognise the *universal* common good of the entire human family. A constant teaching of the Catholic social doctrine has been that whenever a human society exists, some sort of authority must also exist to safeguard and promote the common good of that society. This goes for the world society as well."[39]

The *Compendium of the Social Doctrine of the Church* gives additional insights into this key concept:

> "*The principle of the common good, to which every aspect of social life must be related if it is to attain its fullest meaning, stems from the dignity, unity and equality of all people*. According to its primary and broadly accepted sense, the common good indicates 'the sum of those conditions of social life which allow social groups and their individual member relatively thorough and ready access to their own fulfilment' (GS 26.1).

The common good does not consist in the simple sum of the particular goods of each subject of a social entity. Belonging to everyone and to each person, it is and remains 'common', because it is indivisible and because only together is it possible to attain it, increase it and safeguard its effectiveness, with regard also to the future. Just as the moral actions of an individual are accomplished in doing what is good, so too the actions of a society attain their full stature when they bring about the common good. The common good, in fact, can be understood as the social and community dimension of the moral good.

The common good of society is not an end in itself; it has value only in reference to attaining the ultimate ends of the person and the universal common good of the whole of creation. God is the ultimate end of his creatures and for no reason may the common good be deprived of its transcendent dimension, which moves beyond the historical dimension while at the same time fulfilling it."[40]

¶ IEE vs. the Common Good: A comparison.

The *Ideality-inspired Efficient Equilibrium* (IEE) and the *Common Good* perspectives differ fundamentally in almost every aspect. They share however one basic feature: both carry a normative load as they identify a kind of 'perfect society' and target it as worth being achieved. This means that each of them may inspire or justify political and economic decisions at all levels of a social system. The following comparison between the general interest and the Common Good does not do justice to the whole subject, as it is limited to the four most meaningful dimensions for the present argument.

a. Implementing the Common Good: God's work or human deeds?

The fully efficient equilibrium is referred to as a spontaneous outcome of self-centred rationalities intermediated by non-regulated markets. IEE describes a situation of permanent tension and latent rivalry between fundamentally divergent conflicting interests in everlasting competition for the control of limited available resources. Price mechanism is thus only a method for conflict resolution among rationally calculating agents. IEE requires neither institutions of any kind nor efforts or self-restraint on the part of the actors. It is a steady-state idealised mechanical equilibrium resulting from opposing forces. Quite the contrary, private vices (such as greed) are expected to drive the total outcome spontaneously towards a greater general interest.

"The prerequisites for the Common Good are different: it requires both effort and self-restraint by each and every member of the group or society, and cooperation among them."

The prerequisites for the Common Good are different: it requires both effort and self-restraint by each and every member of the group or society, and cooperation among them. The Common Good will not appear as a '*deus ex machina*'. It will result from cooperation and convergence—through conflict mitigation and resolution because parties are open to higher levels of the Common Good. The ground for common good has to be prepared step by step, day by day, by continuous and conscious efforts in two directions—one structural, the other one virtuous. On one side, the betterment of institutions is instrumental to the Common Good. On the other side, the virtuous behaviour of persons ultimately contributes to changing institutions. In the Christian perspective, the Common Good is a reality progressively emerging out of the imperfect world because of the moral motivation of the daily deeds of all concerned[41].

According to IEE theory, once markets are perfect the optimal situation will last for ever. What exogenous force will bring about such a situation? An external shock is required, a kind of 'act of God' such as the 1986 'Big Bang' in British financial services. However, once the *perpetuum mobile* of efficiency is put in motion, it is expected to run for ever. Therefore, Fukuyama's idea of the 'End of History' (*see* Part I) corresponds fully to the self-perpetuating vision of efficient equilibrium. Once efficiency prevails, time as a vector of change and space as the vector of diversity may melt away and disappear. The world becomes flat and stalled as *perpetuum mobile* takes over. Things are different with the Common Good: the degree of its realisation in any given historical moment depends on the readiness of members of the group to act according to their profound vocation of brotherly humanity[42].

"Things are different with the Common Good: the degree of its realisation in any given historical moment depends on the readiness of members of the group to act according to their profound vocation of brotherly humanity."

b. The underlying anthropology

One of the key differences between efficient equilibrium and the Common Good is the underlying anthropology. For the IEE approach, human beings are self-centred individuals geared toward maximising their own utility or satisfaction, unmoved by others who they consider only as trading partners. The classical *homo oeconomicus*—or his grandson *homo financiarius*—provides the anthropological reference for the IEE context. The anthropological underpinnings of the Common Good are fundamentally different: the person—not the individual—is the reference here. According to the person-centred view, each human being becomes oneself through relationships with other human beings. Every person is at the same time autonomous, but not independent from others. The self flourishes through constant relation with others. Human persons by nature care for others for they can only flourish by giving and receiving love.

For the Common Good, the fulfilment of 'each person' as person (individual and relational) is the only legitimate reference. The Common Good rests on the principle of the inalienable—non-tradable, impossible to compensate for—dignity of each person. In this narrow sense the Common Good is 'egalitarian', as each person is equally incommensurable. IEE takes a radically different, if not contrary approach, in which the weight of one unit in the general interest depends on the absolute 'amount' of utility or satisfaction it generates. In other words, the weight of each member in society corresponds to her or his productive contribution.

The main anthropological difference between the two paradigms discussed here lies in the origin and destiny of man: for the IEE theory man is a self-defined, possibly even self-created, autonomous calculating self. For Christians every person is a child of God anxious to return to his loving Father, his beginning and his ultimate end. The earthly life of a Christian is the part of this journey where he or she can express through deed his or her love for the Father. Because of this difference in anthropology, the two paradigms are unbridgeable.

In the Common Good perspective, human groups (such as families or enterprises) are more than aggregations of individuals. Thus the common good of each of these groups is more than the sum of its individual components. By its very nature, common good cannot be decomposed into its building blocks; it is the good of a group, as a group. The *raison d'être* of the Common Good is the perspective of enhancing the fulfilment—including also the transcendent dimension of unity in God—of each group and of each of its members. It is a fulfilment in line with the personal calling of each and every person, that is, respectful of natural differences. In this sense, the concept of common good sets a dynamic target and extends the concern to the future, and beyond, to the end of times.

On the contrary, economists' concept of general interest recognises exclusively the independent individual interest as an ontological reality. That being said, these individual interests can be mechanically aggregated into larger wholes—such as general interest—or disaggregated, but only for the purposes of calculation. IEE is a static concept leaving no room for change, evolution, or betterment[43].

c. Horizon of action and responsibility of actors

General interest is a concept initially rooted in a long tradition of political philosophy and political anthropology. When this notion was transposed to economics in the late 19th century and then formalised within the IEE approach, a wealth of nuances disappeared, leaving as its only first principle the idea that human nature is based on self-interest. When used today, in most cases (but not all) the notion of general interest refers more to the arithmetic of individual interests and to the *ideal* of models than to philosophical nuances of the previous discussions in political philosophy.

The Common Good has an even longer intellectual history. Its function has always been to provide guidance and a moral compass for individual and for collective acts rather than to propose a detailed description of a dubious arrival point. Indeed, the Common Good is at the same time the ultimate horizon of the end of times and a tension between the present and the arrival point. This notion cannot be properly understood without its eschatological reference: the 'Civilisation of Love' which sets the horizon for the earthly, imperfect reconciliation between the personal good and the universal Common Good[44].

The Common Good sets a horizon and a target beyond the reach of purely human forces. Indeed, tensions between the egocentric and relational dimensions of every human person are part of his nature as corrupted by original sin. What gives ultimate consistency to the Common Good is the hope that the good of persons and the good of communities do not exclude each other but rather that they combine and reinforce each other in the long term. In other words, the Common Good epitomises the ever-growing moral quality of human interactions and, ultimately, of human societies.

The Common Good is at the same time a realistic hope and a conflicting reality. It is not a *deus ex machina* but rather results from a constant search by the concerned actors for the convergence of the concrete, real good of persons and communities. By recognising the conflicting nature of common good, one also acknowledges the room to manoeuvre among the ambiguities, tensions, and complexities of real life within which economic and social actors are bound. Even if it is accepted by Christians that the Common Good will not fully be achieved in historical time, the search for it does not take place in the fantasy of models but in reality.

"Even if it is accepted by Christians that the Common Good will not fully be achieved in historical time, the search for it does not take place in the fantasy of models but in reality."

Asymmetries and inequalities are thus normally present in every group searching and aiming for the Common Good. They are acceptable as long as they are not inequities, injustice, or exclusion—as long as they do not hinder members of the community from reaching fulfilment. When this is the case, members of the group have the moral duty to take action to restore equity and justice—that is, to combat or mitigate relevant asymmetries, so as to alleviate their negative consequences on the weakest. In this context, the principles of Catholic Social Teaching are setting the right—in the moral sense—directions for action, but they leave the ultimate practical responsibility to the actors concerned. In this context, institutions and legal norms setting the ground for a social organisation or an authority dedicated to the Common Good may be helpful in channelling the individual actions in the appropriate direction.

In its pure expression, IEE is timeless and spaceless. However, all the political choices this vision has inspired stem from a consequentialist—or more precisely utilitarian—approach. The only possible justification that this paradigm may provide is the level of total expected outcomes (present and discounted future) for the agent. Therefore the outcome plays the role of moral standard whereby 'more is better'. In the Christian approach, on the contrary, the moral quality of deeds is measured both by the immediate impact on each and every one and by its virtuous character. This means that actions (economic and political) inspired by the two approaches will differ greatly as to the relative weights given to the immediate present and also to the moral quality of the action as such. For Christians the immediate effects on our 'daily bread' are of utmost importance.

d. Fecundity versus efficiency; relations versus transactions

As mentioned above, the IEE construct relies on all present competition (confrontation of mutually exclusive aspirations). In the context of this idealised war of all against all, violence is contained by market mechanisms. In this war, transactions or contracts can be seen as moments of truce. They are minimal points of agreement necessary for exchanging goods and services and more generally necessary for a non-violent, but not fully peaceful, continuation of social trade. Within the IEE paradigm, transactions and contracts are the only patterns of interaction. By definition transactions are equivalent, anonymous, instantaneous, or self-liquidating, and do not generate externalities. As such they play the important role of temporally mitigating tensions, though without resolving them. In fact these tensions have to be maintained as they are the very engines of competition.

From the perspective of the Common Good, human beings have more to gain from cooperation than from confrontation. By nature, human persons are not only individuals but also the nexus of lasting relationships with fellow men and women. Economic exchanges, transactions, or contracts are expressions of unavoidable tensions and needed compromises. But they are just one of the possible patterns of human interaction. Indeed, transactions resulting out of confrontations have to be contrasted with relationships as expressions of cooperation. A relationship is never efficient in the economic sense because, at every single moment, it is by definition unbalanced, open-ended and multi-dimensional[45].

"In the short term, relationships appear genuinely non-efficient in the market, for they divert resources from other uses. In the longer term however, the gratuity, risk-taking, spontaneity, and incommensurability which are embedded in any relations may prove fruitful. These benefits are impossible to anticipate or account for with precision."

Relationships are by their nature the place where incommensurability, gratuity, and spontaneity take root. In the short term, relationships appear genuinely non-efficient in the market, for they divert resources from other uses. In the longer term however, the gratuity, risk-taking, spontaneity, and incommensurability which are embedded in any relations may prove fruitful. These benefits are impossible to anticipate or account for with precision, but they may be economic, spiritual, and social—such as mutual trust, reciprocity, resilience, or unexpected innovation.

On the other hand, a transaction in perfect and instantaneous markets is always efficient but also atemporal. In the world of perfect competition and of general interest, every possible bit of information about possible transactions is accounted for in the price. Externalities are thereby fully internalised, making the prices efficient. This situation leaves no room for gratuity and no room for the unexpected. Under the reign of efficiency there is no room left for fecundity, which by definition is gratuitous, unexpected, and impossible to account for[46].

Combating asymmetries: Putting the principles of CST in motion

The Common Good has to be built and thus requires the efforts of Christians and of men and women of good will. These efforts have to be consistently pursued on three levels: on the structuring macro-level of institutions broadly understood as setting lasting frames for human interactions, on the meso level of mechanisms which are the more volatile patterns of interactions (such as enterprises or other groups), and on the micro-level of direct personal deeds. These levels differ in their leverage. The higher the level of action, the broader will be its potential structuring effects on actions at other levels. Despite the difference in leverage, the nature of decisions and actions is the same at every level. At the macro, meso, and micro levels persons have to make decisions in unique circumstances and implicitly or explicitly take a moral position[47].

The second section of Part III explores some issues related to the main principles of Catholic Social Teaching, whose efforts inspired by the Common Good could significantly contribute to reducing asymmetries and restoring equity and justice without threatening the basic principle of economic freedom on which the construct of the market economy stands.

❡ Misplaced trust: Destroying the golden calf

Since 2007, it has been an open secret that finance has failed to deliver on its promises. There is however less agreement on the reasons for this failure. The most widely recognised of causes of the crisis are the many dysfunctions since identified within the world of finance—such as greed, abuse of trust (moral hazard), information asymmetry, and conflicts of interest. All these dysfunctions would not have done the damage the world has witnessed since 2007 if another less-acknowledged cause had not gone on unnoticed for decades. Western societies implicitly accepted the promises of progress towards a better world built upon technical rationality. As financial mavericks were part of these promises of technical rationality, the necessary room to manoeuvre was granted to finance. The rationale for accepting the deal was the hope and expectation that additional monetary resources—generated by finance—would appease the growing existential anguish of the West 'liberated' from religious myths. Technical rationality inspired by financial science spread across free global markets, drowning immaterial concerns with material wealth and a false sense of security.

The underlying reason why finance will ultimately deceive is the simple fact that finance cannot provide a lasting solution to the existential fears of the developed world. In other words, the true reason for the deceit after three decades of financial euphoria is that finance did not deserve all this trust in the first place. To put it simply: trust was misplaced. Western societies took financial promises at face value without conducting even minimal philosophical 'due diligence'. The same policymakers and key intellectuals that laid the groundwork for financial euphoria have been deliberately deaf to generations of moralists who never really stopped warning against the dangers of monetary seduction, from the Gospel[48] and St John Chrysostom[49], to more recent philosophers Jacques Ellul[50] and François-Marie Monnet[51], and finally to Pope Francis in *Evangelii Gaudium*:

> "One cause of this situation is found in our relationship with money, since we calmly accept its dominion over ourselves and our societies. The

current financial crisis can make us overlook the fact that it originated in a profound human crisis: the denial of the primacy of the human person! We have created new idols. The worship of the ancient golden calf (cf. *Ex 32:1-35*) has returned in a new and ruthless guise in the idolatry of money and the dictatorship of an impersonal economy lacking a truly human purpose. The worldwide crisis affecting finance and the economy lays bare their imbalances and, above all, their lack of real concern for human beings; man is reduced to one of his needs alone: consumption.

While the earnings of a minority are growing exponentially, so too is the gap separating the majority from the prosperity enjoyed by those happy few. This imbalance is the result of ideologies which defend the absolute autonomy of the marketplace and financial speculation. Consequently, they reject the right of states, charged with vigilance for the common good, to exercise any form of control. A new tyranny is thus born, invisible and often virtual, which unilaterally and relentlessly imposes its own laws and rules. Debt and the accumulation of interest also make it difficult for countries to realize the potential of their own economies and keep citizens from enjoying their real purchasing power. To all this we can add widespread corruption and self-serving tax evasion, which have taken on worldwide dimensions. The thirst for power and possessions knows no limits. In this system, which tends to devour everything which stands in the way of increased profits, whatever is fragile, like the environment, is defenseless before the interests of a deified market, which become the only rule.

Behind this attitude lurks a rejection of ethics and a rejection of God. Ethics has come to be viewed with a certain scornful derision. It is seen as counterproductive, too human, because it makes money and power relative. It is felt to be a threat, since it condemns the manipulation and debasement of the person. In effect, ethics leads to a God who calls for a committed response which is outside the categories of the marketplace. When these latter are absolutized, God can only be seen as uncontrollable, unmanageable, even dangerous, since he calls human beings to their full realization and to freedom from all forms of enslavement. Ethics—a non-ideological ethics—would make it possible to bring about balance and a more humane social order. With this in mind, I encourage financial experts and political leaders to ponder the words of one of the sages of antiquity: 'Not to share one's wealth with the poor is to steal from them and to take away their livelihood. It is not our own goods which we hold, but theirs.' "[52]

At the root of the present crisis lies a seductive worldview which, in fact, derives from a fourfold confusion—characteristic of our times—which resulted in misplacing trust in financial techniques:

- ***Confusion between finance as a means and finance as an end in itself***. As a succession of numbers, money is infinite. Hence, the accumulation of monetary wealth theoretically has no limits. The same is true of greed, which aims to have more, solely for its own sake, without any other external objectives. When the distinction between ends and means loses its sharpness, the temptation arises to see the accumulation of liquid wealth as self-actualising;
- ***Confusion between the person on the other side of the deal and the faceless anonymous market***. In modern financial markets, anonymous crowds of financial asset holders interact through standardised contracts. In this perspective the personhood of 'the other' disappears or dissolves into the faceless mass. In a fully anonymous and depersonalised context where persons are replaced by abstractions such as 'market' or 'consensus', the notions of ethics, of *ex ante* responsibility for deeds and their consequences, lose their meaning. At best, responsibility is limited to *ex post facto* monetary compensation for damage[53]. This confusion may destroy any sense of *ex ante* responsibility on a very large scale;
- ***Confusion and insensitive trade-offs between the present, the future, and often the past***. Finance is about inter-temporal dealings in which time is just an objective variable in the equation. The use of a discount rate gives a financial expression to time, but erases the sense of the existence of agents in a given historical moment. From a purely financial perspective future and present become tradable. This is not the case in real life where time has a subjective and irreversible character. Time is not just a chronological succession of equivalent and interchangeable seconds. It is a set of unique moments of uneven, subjective density and importance. Financial lenses do not capture the *kairos* of time; they ignore or even contest its very existence. By refusing the *kairotic* dimension of time, finance threatens to dehumanise it.
- ***Confusion between reality and virtual reality***. At one end, modern finance manipulates symbols in an abstract virtual world of formulas and spreadsheets. Meanwhile, at the other end, finance deals with payment flows, ownership, debt, and the creation and trading of assets, and as such belongs to the actual world of real human deeds. The legal system and other rules (such as accounting) are there to make the two coincide. Virtual reality is more than just a passive 'mirror image' of reality in an era of light-speed information technology, because virtual reality and reality are today interdependent. However, the nexus is anything but perfect, in that they often do not fully coincide. The virtual picture is often simpler, more straight-forward and with less nuance and discontinuity. It is more often about scalable figures than about real people and dissentious bricks and stones. Finance, by design, op-

> erates in a smooth virtual reality and only indirectly shapes reality. Because of the illusory character of virtual reality, financial professionals tend to underestimate the resistance and the constraints of reality.

These four confusions made their way into the minds and perceptions of many during the decades of unprecedented expansion of finance. They contributed greatly to renewing and reinforcing the idolatry of finance and money. The eternal seductive power of money, reinforced by these modern confusions, contributed to constructing an IEE worldview: ***a faceless world*** (un-human), ***timeless*** (i.e. eternal and beyond history), ***abstract*** (self-contained, without reference to reality), ***and self-actualising***, a world driven free from moral restraint and ultimately driven by the instinct of limitless accumulation (greed).

"Humanity has to free itself from monetary and financial idolatry by destroying the golden calf, and by doing so, to rediscover its true calling to the Common Good."

The crisis took off the masque and helped to discover the full picture of progressing idolatry. As mentioned in the Introduction, the crisis must be seen by people of good will as an opportunity to take adequate action and to renew contact with reality: with the people, with the existential dimension of time. It is an opportunity to rediscover how constructive finance can be when put at the service of a greater cause.

The present crisis will last as long as misplaced trust in financial technicalities is not redirected to where it belongs. Humanity has to free itself from monetary and financial idolatry by destroying the golden calf, and by doing so, to rediscover its true calling to the Common Good. Catholic Social Teaching is of great help, for its core principles are inspiration for possible actions leading ultimately to rediscovering the economic and social dimension of faith.

¶ The pre-eminence of the family and the subsidiarity of state policies in matters of solidarity: 'The missing 50%'

Economic discourse is focused on those who are fit for productive activity. This means that about half of any given society is not directly on the radar of economists. The 'missing 50%' is made up of children and the elderly at either end of the spectrum, as well as of those whom the 'market' rejects—for a number of possible reasons—as unfit for productive work. From the economic perspective, these groups appear at best to be beneficiaries of public transfers; at worst to be burdens and sources of cost to society[54]. Therefore the volume of public transfers is the usual economic measure of solidarity. Once defined in this simplistic way, solidarity appears automatically as a threat to economic efficiency, because of the corresponding taxation and transfers which by-pass market discipline. This view of solidarity is too reductive: even if greater solidarity and mitigation of inequalities require increased sharing, this does not simply boil down to higher taxes and expanded social policies[55].

"Solidarity means the sharing of scarce resources—whatever the nature of these resources might be. If money can buy a lot, solidarity in its genuine sense is multidimensional and extends well beyond money."

Solidarity means the sharing of scarce resources—whatever the nature of these resources might be. If money can buy a lot, solidarity in its genuine sense is multidimensional and extends well beyond money. Solidarity, as a horizontal bond within groups, may be effective at different levels and, paradoxically, highly efficient in the real world.

The first and immediate level of solidarity in any society is family—narrowly as well as broadly defined. The family is the place which generates what money cannot buy and which is at least as important for human dignity as sheer money. But family is also the place where revenues and monetary resources are used for the family's common good. In Northern societies, family solidarity is shrinking to its narrowest limits, as exemplified by the number of single-parent households. Where family solidarity ceases to function, public or market institutions are called upon to fill in the gaps. However they operate only in money- and transaction-related categories. In the South, family-based solidarities are stronger, but shrinking especially in cities. The amounts of remittances sent by migrants back home are the best illustration of how strong family bonds of solidarity may be. This suggests that, in the North as well as in the South, any act—personal or institutional—which increases the autonomy, the role and the resources of families is a highly efficient way to enhance solidarity and mutual responsibility in society. In this respect, as well as in many others, public authorities should not forget that its role is to serve and strengthen families, not to substitute for them or to replace them. An often-forgotten principle of CST is the subsidiary role of the State in respect to families. Reinforced by public means, solidarity within families is thus central to CST.

The second level of solidarity is related to an inclusive labour market. The workplace is not only the place where income is earned, it is also where one's capacity to contribute to the common good of the group is recognised. Inclusive workplaces, policies, and attitudes require the willingness to share—work and earnings—of all concerned. Like in the parable of the eleventh hour workers[56], workloads (i.e. productivity) and remunerations are to be shared so as to allow for the weakest to earn their living with dignity. This means that the enterprise has to be seen also as a community pursuing its own specific common good, where internal solidarity has a role to play. In this respect, much depends on the way the owners (shareholders) and the management team understand their roles in developing solidarity among the different components of the enterprise. Such attitudes run directly against the dominant managerial mantra according to which efficiency requires demutualisation and strict equality between the contribution to productive effort and the corresponding remuneration. In most enterprises—especially large ones—remunerations are therefore increasingly strictly 'productivity related'[57].

Solidarity through money transfers is the third level of solidarity. It is the most visible, the one on which economists mainly focus, the easiest to account for, but also the least personal and the easiest to prevaricate. In the world of growing inequalities and exclusion, so-called public social transfers play a growingly important role as they serve as back-stop for those who fall through the nets of the first two levels of solidarity. The relative size of public transfers differs greatly from one region to the other and is also related to the level of income: in the so-called 'high income countries' they amount to about 12% of national income, while in Latin America they reach 4% and in Africa remain around 1% of corresponding national incomes. Total monetary expenses on behalf of official development aid amounted in 2012 to $130 billion US, slightly less than 0.3% of aggregate national income of the donor countries. Despite the limited overall amount, for many least developed countries, receiving these transfers is critical.

Charity and philanthropy may be seen as the fourth level of solidarity. In situations where the third, public level of solidarity is too weak or dysfunctional, charity and philanthropy play an absolutely key role in limiting the most acute exclusion.

The financial crisis has shown the fragility of situations where money transfers are called in to replace (shrinking) family solidarity. The fragility of a public transfer-reliant social fabric in the North is clearly visible today. The non-viable character of this situation and its unsustainable financial consequences lie at the root of the recent European debt crisis. Families, individuals, as well as enterprises should draw the appropriate lessons from this experience and take steps to cure the problem at its root. Institutional as well as private efforts should aim at reinforcing genuine solidarities on the family and enterprise levels. Such measures, when carried out with due attention to the human dignity of all parties concerned, will inevitably deepen social relations, thereby preventing exclusion due to their face-to-face character. For this very reason, such initiatives also may give greater scope to the fruitfulness of inter-personal relations and not only to efficiency-driven transactions. Such actions and measures require courage, imagination, and inspiration—which CST may provide.

¶ Increasing solidarity between labour and capital: Reinventing the corporation

Two other asymmetries identified in Part II could be efficiently reduced through solidarity-inspired measures: asymmetry between labour and capital leading to the supremacy of the latter, and asymmetry between the real and financial dimensions of economic activity. Addressing the asymmetry between labour and capital supposes the re-examination of the purpose of the corporation. Is the enterprise (or corporation) an instrument in the hands of shareholders to generate returns on their investments? Or is it a method of cooperative relations (and not of contracts as usually said) between respectful partners with its own, peculiar common good[58]?

"Is the enterprise (or corporation) an instrument in the hands of shareholders to generate returns on their investments? Or is it a method of cooperative relations (and not of contracts as usually said) between respectful partners with its own, peculiar common good?"

The shareholder value philosophy—discussed earlier—carries with it one of the most pervasive of such inequities. It is based on the belief that the primacy of the interests of virtual and nomadic shareholders a) is natural (and therefore rightful and efficient); and b) trumps the interests of the employees and clients stuck in real contingencies. In 'global giants', this fundamental asymmetry is reinforced by the remoteness and anonymity of decision centres from places where the decisions produce real life consequences. In order to mitigate these asymmetries, new institutional as well as personal avenues must be opened. From the CST perspective, the most important step should be the acknowledgement at the level of enterprise and legal framework, of the legitimate existence of an enterprise's common good as a moral but also a managerial value. If it were publicly and legally recognised, this common good would acquire its own legitimacy. It would consequently open doors to more solidarity among the so-called stakeholders and to more appropriate management behaviour[59].

"The most important step should be the acknowledgement at the level of enterprise and legal framework, of the legitimate existence of an enterprise's common good as a moral but also a managerial value."

At the macro level, these efforts could be supported by a better alignment of speed and volatility between financial transaction (milli- or nano-seconds) and the real processes (in days, weeks, and even years). Increased viscosity of financial markets could be enhanced by dedicated tax measures giving a premium for greater shareholder fidelity. This of course implies that shadow finance is forced to come out of the shadows.

¶ More solidarity between lender and borrower: Debt rescheduling

Most contemporary legal systems agree that, when debt is granted on non-usurious conditions, all consequent obligations have to be paid to the last penny. A credit/debt contract is a peculiar and complex transaction as it establishes a lasting asymmetric interdependence between payment on the spot and commitments which bind despite an unknown future. For centuries, this fundamental asymmetry—acceptable credit conditions, interest rates, and the moral obligation to lend to the poor and needy—have been addressed by Christian theologians[60].

Much of the moral debate points to the asymmetric distribution of risk between the borrower and the lender. Indeed, unlike equity financing which creates a de facto partnership and establishes a limited solidarity between parties, a credit/debt contract sees to the contrary a borrower assuming the risk related to the expected outcome of his project. That is, the borrower gambles his future fortunes, while the lender keeps only the residual risk of the debtor's insolvency. As long as the borrower has any resources, he will be pressed by the legal system to service his debt. Once he reaches a certain threshold, he or she may take refuge in bankruptcy or insolvency which are forms of default accepted by modern legal systems. Sharing being central to the principle of solidarity, one could argue that solidarity should also involve risk sharing. That being said, when the burden of debt becomes unbearable, Christians in line with the Old Testament book of Leviticus would prescribe an outright debt restructuring in the name of solidarity.

One of the many asymmetries identified in previous parts refers to those who have committed their future for the sake of the present on one side (borrowers), and those who have bought these future promises with previously accumulated savings on the other (lenders). By doing so, the lenders may have committed their future destiny to the borrowers. When the burden of debt pushes the debtor into poverty, a moral issue arises for the lender: what is the ultimate level of pressure he can morally exert on the debtor? The *Pater Noster* provides an indication: lenders should be as generous with debtors as our heavenly Father is with us. This means, at least, that debt

"Debt ought to be renegotiated in the name of solidarity when the situation of the borrower has changed sufficiently to make the burden on his shoulders too heavy for him to carry. Such a renegotiation may also serve the interest of long-term efficiency."

ought to be renegotiated in the name of solidarity when the situation of the borrower has changed sufficiently to make the burden on his shoulders too heavy for him to carry. Such a renegotiation may also serve the interest of long-term efficiency. Thus, unlike legal systems, the Christian view on debt stresses the implied dimension of solidarity that binds the borrower and the lender. In a Christian perspective—in the name not only of solidarity, but also of justice—debt renegotiation ought to be as frequent as required by the changes each of the two parties to the contract experience in their situations, needs, and possibilities. This applies to debtor and creditor alike. Indeed, the moral order, unlike the legal one, has no difficulty in recognising that debt contracts entail a parallel set of moral responsibilities: the responsibility of the borrower for the lender and the responsibility of the lender for the borrower. In this way the intrinsic asymmetry of a debt relationship can be mitigated when needed.

In the present crisis, until very recently, the prevailing legal position was that financial contracts are inviolable: their clauses have to be respected in any circumstances. Now the idea of substantial debt rescheduling is making progress in international fora. What are the grounds for such change? A sudden bout of generosity on the part of the lenders? A new feeling of solidarity for the hardship of borrowers? Or rather a fear that if borrowers are pushed into default, lenders shall also suffer? The recognition of the paradoxical interdependence between lenders and borrowers is at the centre of the ongoing ethical and strategic discussions about the pros and cons of macro-economic debt restructuring.

The main reason behind the idea of the Leviticus Jubilee was that the over-indebtedness of some would break the community by excluding some of its members, by excessively concentrating ownership, or even by transferring ownership outside of the community. Jubilee, the Sabbath of Sabbaths, was supposed to occur every 50th year. That year, unpaid debts were cancelled as well as transfers of collateral that happened in the meantime. The simple existence of such a general and exogenous constraint fundamentally changes the relationship between the borrower and the lender. By this simple fact the lender becomes interested in the timely and smooth repayment of debt and the risk asymmetry between the two parties is reduced. The exogenous deadline proposed by the Jubilee is an interesting avenue to encourage lenders to take their responsibilities seriously, in the name of solidarity and the Common Good; this is especially true when credit demand is bullish[61].

❡ *The call for subsidiarity: A challenge for the 'global giants'*

The principle of *subsidiarity* is particularly useful in the context of designing political organisations. Subsidiarity aims to preserve the autonomy of smaller social groups. It shelters them from an invasive trend towards centralism. While primarily advocated in the realm of politics, subsidiarity should also be used when addressing the question of the appropriate size of economic organisations, i.e. of enterprises.

Although there is no single method for assessing the size of an enterprise (employees, assets, turnover, capitalisation, etc.), it is obvious that the size and power position in markets and within global value chains matters greatly in economic life.

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As mentioned in the first part of this report, the main drivers of globalisation have been very large financial and non-financial enterprises. Many factors have driven their growth, such as economies of scale, of scope, or of speed. These organisations have expanded through large and complex networks of affiliates and partner organisations. The question to be asked in the specific perspective of CST is to what extent, and under which conditions, does the search for efficiency at the level of one single enterprise justify the existence of colossal organisations? Is economic gigantism respectful of the principle of subsidiarity? Do these organisations really generate the above mentioned returns by themselves, or are they simply siphoning off what would otherwise occur to other, often smaller players? In ideal conditions, the above two questions are senseless, as perfect competition evens out the relative power of every player. But because the ideal and reality differ, the principle of subsidiarity applied to the economic context may provide some indications of where the limits of gigantism should stand and how larger enterprises may respect and support the autonomy of their smaller and weaker partners, clients, and suppliers.

Almost by definition, entrepreneurs and managers do not spontaneously seek external competition. For obvious reasons, largely inspired by the managerial mantra, they search for niches and prefer safe harbours of legally established patents, brands, and labels which lessen competitive pressure. Dominance and market power seem to be, more often than not, the outcome of 'markets' where competition is not enforced by an external body. Unlike on national agendas—including the European one—where competition policy and authorities do have a say, global competition policy is not yet at the top of any international agenda[62].

Not much empirical work has been devoted in recent decades to the level of competition and concentration in global markets. Using classical methods, the limited evidence collected has not thus far shown that globalisation increases levels of market-share concentration on an industry-by-industry level. However, as shown previously herein, globalisation has changed the way the transnational economy works. Indeed, sparse but converging data show progress in the macro-economic relative weight of giants and also in the relative economic weight of industries where they are dominant (telecom, internet, automotive, banking, air transport and production, etc.). Additional evidence from the global value chain approach suggests that on one side, as shown by their consolidated balance sheet, giants are less vertically integrated than they used to be a few decades ago. But on the other side, data suggest that their strategic weight and negotiating power has increased as they control a growing number of specific (often immaterial) assets which grant them an unsurpassable competitive advantage. Thanks to such a privileged position economically and legally defended, the 'lead firms' can use their pricing power to siphon off technical efficiency gains—and portions of what theory calls 'consumer surpluses'—from their supply chains, their distribution chains, and from their final clients. In such a configuration, the real power asymmetry between 'lead firms' and the smaller players goes unnoticed by the classical measures of concentration still used by authorities and researchers. A number of recent legal cases in US and EU courts have shown how technological intricacies have been used by major players in software and computer industries to protect their rents not only in relation to their direct competitors but also their suppliers and partners.

The principle of subsidiarity is cited as a reason to contain centralising tendencies of political authorities and protect local autonomies and their respective common goods. In these discussions, the centralised argument of 'one size fits all' clashes with demands for local autonomy, cultural diversity, shorter decision processes, and possible greater flexibility. Analogous discussions seldom take place in a purely economic context where lower prices and higher returns systematically have the last word. From the Christian perspective, the question of subsidiarity should be addressed in a broader context (i.e. not exclusively efficiency-related). It calls for a way to preserve the autonomy of enterprises and their right to grow[63].

In order to bring the economic subsidiarity issue onto the agenda, two courses of action have to be pursued. On one side, Christian managers have to strive to explicitly take into account the needs of the other party in their strategic and commercial dealings. In practical terms it means that managers of powerful enterprises should pay attention and respect the autonomy of their suppliers and distributors in their negotiations. Some of these issues are addressed by initiatives such as 'ethical sourcing'. The Christian managers and shareholders should be able to ask, but also answer the self-disciplining questions of 'how big is too big' or 'how powerful is too powerful'? These questions have meaning only if one cares for a common good of a higher level than that of one's company alone.

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At a public level, measures have to be prepared in order to limit the asymmetry in the market and the economic power of players. These measures derive from the Christian concern for subsidiarity but are perfectly aligned with the concern for a realistic betterment of market competition. The subsidiarity principle can provide a political compass in this context. This principle should be advocated to support partners and local competitors to contain the strategic (market) power of global giants. On the regulatory level, one could imagine stricter monitoring of abuses of domination in economic transactions, including easing conditions and the generalisation of 'class actions' in continental jurisdictions. One could also think about changing the present accounting rules which allow transnational enterprises to provide only very synthetic information about their local operations. Present consolidation rules also provide a shelter to large players in terms of their tax and transfer pricing behaviour. Both of these issues may well be sources of economic power and rents as discussed above.

One interesting idea how to contain gigantism comes from the recent work of the Financial Stability Board in its important conceptual, fact-finding, and regulatory research on 'global systemically important financial institutions'. The idea behind it is that in the financial sphere some institutions are 'more equal than others', and as such need special attention and possibly a specific regulatory counter-weight. The use of the subsidiarity principle in the economic context deserves for a similar conceptual and fact-finding work to be carried out on other sectors so as to identify the possible 'systemically important players'. Indeed, some of the well-known 'global giants' might have acquired systemic importance—unnoticed until now—in the world society and economy because of their size, the uniqueness of (often immaterial) assets they control, the complexity of their global supply and distribution network, their negotiating power, and so on. Very little is known today about these global giants beside what they decide to make public, mainly through their annual financial reports.

In order to correct the fundamentally asymmetric situation which gives to global giants a systemic advantage, a conceptual, statistical, and documentary work should be initiated in order to balance systemic advantages with systemic responsibilities. For this purpose a dedicated task force should be formed within the system of the United Nations, drawing on specific competencies present in organisations such as ILO (industrial relations), WIPO (intellectual property), WTO (trade), WHO (pharmaceuticals and health), ITU (telecommunications), FAO (agriculture and food), UNCTAD (development) and OECD (taxes and finance). Momentum among these organisations should be generated—with NGOs and developing countries as the impetus—in order to overcome the foreseeable resistance of enterprise lobbies (such as the International Finance Institute or World Economic Forum) and of their home country representatives. One of the possible medium-term outcomes of such work could be the definition of a new international status and corresponding responsibilities for 'global systemically important enterprises'. Such a status should carry with it stricter regulatory and reporting requirements for the enterprises concerned.

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¶ Responsible ownership and the universal destination of goods

The issue of ownership is an important aspect of Catholic Social Teaching. Land and real estate ownership have always been seen as a guarantee of autonomy for the family and a means to pursue its own common good. Consequently, the importance of ownership for the proper working of the economy and society has always been acknowledged as simultaneously a source of rights and a source of obligations for the owner. The balance between rights and obligations deriving from ownership has been debated for centuries, but the general idea that ownership carries with it a ‘social mortgage’ which limits the moral right of the owner to exclude others from benefiting from the thing owned, is generally accepted in CST.

“By no means can ownership be seen as an absolute moral right of excluding the non-owners from accessing the good in question.”

The Christian principle of the ‘universal destination of goods’ makes clear that by no means can ownership be seen as an absolute moral right of excluding the non-owners from accessing the good in question. On this point the Christian view is much more demanding for the owner than most modern legal systems, as it makes the owner morally responsible for the care and best possible use of his or her belongings for the sake of the Common Good. Hence, the Christian perspective weakens or even inverts the asymmetry between owner and non-owner. Calvin, for instance, expressed a radical view stressing the burden of responsibility on the shoulders of owners for making the best possible social use of the good owned. For Calvin, the moral duty and the corresponding responsibility for taking care of what was given by God comes first, before the right to personal enjoyment[64]. Some modern legal systems still maintain vestiges of a ‘social mortgage’ as an element of ownership rights. The very fact of assigning ownership rights with similar moral caveats allows for linking this discussion with the one on subsidiarity. The governance of natural resources as well as other physical assets most respects the Common Good—if not necessarily *Pareto efficiency*—when it takes into account all the claims and expectations of those immediately affected.

Our previous discussion of the notion of the Common Good has shown the potential tension between competing common goods. Such a tension is part of everyday life. It can only be solved by extending one’s perspective to a greater common good, i.e. the common good of a higher level. The same tension is present in the Christian reading of ‘ownership rights’ because it recognises the concurrent legitimacy of classical owner’s rights and of the ‘universal destination of goods’ principle. The effective articulation of these two potentially conflicting presuppositions is not easy and has never been easy in history. Many solutions have been invented across cultures, space, and time to manage non-appropriable resources, such as the well-known ‘commons’. Globalisation has contributed to transposing the debate to a global level to address the most adequate mode of governance of the ‘global commons’, such as the oceans, atmosphere, water resources, the climate, and so on.

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That being said, much of the intellectual and moral argument around ownership dates back to times when the physical goods and natural resources such as real estate were, together with money, the only reference of ‘ownership’. Today, the scope of the question is much broader because of the recent extension of ownership rights to the virtual world of immateriality. The major difference comes from the fact that immateriality is by definition not exclusive. Indeed, ownership rights are put in place on immaterial items to protect the owner’s revenue flow (i.e. rents) and not, as in the case of goods or services, his possibility to use or consume the items in question.

Things have changed since the time of the first articulation of the principle of the universal destination of goods, particularly in the latter decades of the 20th century. The basic idea that clearly assigned ownership rights enhance efficiency and that their protection stimulates innovation is almost universally accepted today. The global framework for intellectual property rights has therefore been strengthened and expanded. Correspondingly, rights to the access and use of immaterial goods such as knowledge, art, or genomes of species¬—goods over which it is impossible to exercise physical control—have been assigned to intellectual property 'owners' with the resources and sophistication necessary to defend their legal rights within existing legal frameworks.

In an economic sense, owning such intellectual property rights allows for selling access and generating an income every time the corresponding right is used. This means that immaterial ownership rights, much like rights on future revenue streams, are today's counterparts to financial assets and appear as such on company balance sheets (often called goodwill). Such assigned ownership rights generate income and returns only because they can be enforced by law so as to exclude potential users. As opposed to the natural world where scarcity is a reality, in the immaterial world of potentially infinite non-exclusive utilisation, scarcity is a pure artefact of economic logic and legal engineering[65].

Does the search for economic efficiency—or the protection of monopolistic rent—morally justify the exclusion of those who cannot afford to pay for access to ever larger portions of knowledge and creativity locked in by the various instruments of intellectual property protection? What if such artificial appropriation takes away from many the means of their subsistence as is for instance the case with seeds and fertiliser in the developing world[66]?

This drive towards a concentration of control over critical material as well as immaterial assets in the hands of a select group of players pushes our civilisation towards a fundamental change which Jeremy Rifkin termed 'the Age of Access'. When every single item in immateriality has a fully assigned owner, then markets are 'complete' in the sense of IEE theory, free riding is impossible, and the highest economic efficiency is achieved. However, what seems bright in the ideal, is often much bleaker in reality. The extension of ownership to immateriality is in many ways analogous to the 19th century introduction of 'enclosures' in pastoral lands of the United Kingdom and the United States. This 'privatisation' of previously freely accessible pastoral and water resources initiated a deep restructuring in agriculture and subsequent massive migrations of the poor into urban centres. Enclosures did set the ground for the Industrial Revolution, but at a cost of massive suffering. Today, these artificial and immaterial estates are being 'enclosed' in full legality by the extensions of intellectual property rights to the natural endowment and talents received from God. The same logic is increasingly a threat to clearly natural flows which used to be known as 'free goods': clean water, air, or even winds.

This trend poses the question of moral limits to the appropriation and corresponding marketisation of access rights. What in this context is the meaning of the broad principle of the universal destination of goods? The question has to be addressed simultaneously at the level where legal norms are crafted—including at the World Intellectual Property Organisation—and at the level of every single economic, artistic, scientific, or intellectual actor. In the context of globalisation, widespread free riding, and the race to gain the prime mover advantage (moral hazard), any isolated virtuous behaviour in the field of immaterial ownership rights—e.g. by granting free access to a specific immaterial ownership right or good—will have only limited impact, as another actor will immediately take advantage of it. In order to be effective, such an initiative requires a legal framework which grants legally enforceable free public access to a given resource. Examples are well known: Wikipedia or Open Source software, e-mail, and partially the World Wide Web itself. In these cases, clearly assigned ownership rights are assigned to the public and pre-empt any further appropriations. However these are only imaginative exceptions trying to contain the trend towards a comprehensive appropriation of immateriality. Parallel to such innovative solutions, a structural change is needed, and the principle of the universal destination of goods could be useful as inspiration for national and international initiatives aimed at containing the appropriation trend which is on the flip side also a trend toward economic rent-seeking. National authorities—especially in developing countries—and the World Intellectual Property Organisation are the places where critical thinking and proposals should be discussed and transformed into norms[67].

❡ *Framework for the Common Good: Mitigating systemic vulnerabilities through better governance and responsibility*

For Christians, the Common Good results from converging efforts mitigating tensions and allowing conflicts to be solved by also discovering convergences at higher levels. Today, no global or universal authority is in charge of the Common Good—the universal common good of humanity. Instead we have a network of dynamically interacting, interdependent local and partial common goods. The progress towards the Common Good could result from these interactions, provided that they are adequately streamlined. In the worst case scenario, when local or partial common goods are in direct opposition to one another, it will tend toward a zero sum. On the contrary, it will tend to the infinite when the same local common goods promote each other. Therefore, the way local common goods interact is critical for the global outcome. In this respect, lessons should be drawn from the systemic crisis of finance.

"Clearly the vulnerability of any system increases with a) its complexity; and b) the absence of explicit regulatory tools."

Clearly the vulnerability of any system increases with a) its complexity; and b) the absence of explicit regulatory tools. The complexity of the contemporary world is also due to a wide range of self-regulating, self-governing, semi-private bodies and networks which are very important for international business life. Such bodies produce so-called 'soft law', or the partially public norms based on international private agreements resulting from autonomous initiatives. Such norms have flourished in past decades in domains such as accounting and auditing norms, and technical and quality standards, but also in finance with the so-called prudential norms elaborated under the auspices of the Basel Committee.

In the absence of world government—i.e. an accepted one-dimensional hierarchy of power—many influences currently attempt to have their say on how local common goods should interact. In order to avoid excessive complexity or enduring and overt conflicts between local common goods, two conditions have to be fulfilled. The first condition is a) the mutual recognition of the irreducibly heterogeneous nature of interacting common goods; and b) the corresponding legitimacies of each of these common goods. The second condition entails a moral responsibility and accountability for all local common goods for the care of the Common Good.

It is symptomatic that immediately after the systemic nature of the financial crisis became evident, the G20 appointed itself as a world governing body and explicitly took charge of the earthly dimension of the Common Good. However, from one communiqué to the next, it is becoming increasingly clear that the initial ambitions are being trimmed down by political disagreements. The initial ambition is today out of reach because of a lack of adequate instruments for action and the corresponding unfeasibility or lack of shared will to build them. Any attempt to break the dead-lock has to progress along the two above mentioned lines: a) increasing the coherent operation of heterodox legitimacies; and b) the parallel extension of mutually recognised responsibility and accountability for the Common Good. Both of these lines of action are fully compatible with the Christian approach.

In order to break the current deadlock and move from a non-system to a higher level of systemic coherence in the world economy, the notion of legitimacy as the source of accepted authority has to be revised. In the contemporary trans-national environment, six types of authority, each rooted in a specific source of legitimacy not only coexist, but also compete for a say in global affairs:

"In order to break the current deadlock and move from a non-system to a higher level of systemic coherence in the world economy, the notion of legitimacy as the source of accepted authority has to be revised."

- ***Political authority*** is still the prominent source of power because it ultimately commands the use of force. Its legitimacy lies in international recognition and a more or less democratic representation mechanism;
- ***Economic and technical authority*** derives its power from the operational effectiveness of global giants; its legitimacy is rooted in the capacity of enterprises—especially large enterprises—to act;
- ***Expert or epistemic authority***, whose knowledge is the source of its legitimacy; thus, the participation of experts in decisional processes

is legitimised. Expertise is often disputed between academia, think-tanks, and NGOs;

- ***Authority of the media***, in their original vocation and role of presenting independent views and challenges to established opinions. Today their power to amplify the actions and opinions of those whom they like or hate is immense. For this reason, media are de facto a part of any decision-making process. Media derive their legitimacy from their power of making noise, of challenging, or even of destroying the reputation of personalities, enterprises, and even regimes or countries;
- ***Prophetic authority*** derives its legitimacy from the capacity to speak out for the higher good of humanity. Some NGOs and religious leaders pretend to be in this position, but very few are able to speak up in a truly disinterested manner in the name of humanity while serving the weakest and the Common Good.

"The challenge of global governance, of which financial governance is a part, consists in finding appropriate ways to combine these different authorities harmoniously and coherently in a joint decision-making process so as to make them share not only power but also the corresponding responsibilities."

These five authorities differ as to the source of their legitimacy, but they all have their place in the process of global decision-making in matters concerning the Common Good of humanity. These authorities operate regardless: they combine in networks, chains, alliances, partnerships of all kinds, norm-setting clubs, etc. The challenge of global governance, of which financial governance is a part, consists in finding appropriate ways to combine these different authorities harmoniously and coherently in a joint decision-making process so as to make them share not only power but also the corresponding responsibilities. The progressive implication in the global financial and economic governance of systemically important banks and enterprises (discussed above) with the corresponding responsibilities could be a first but important step towards a constructive way of caring for the Common Good. Rather than staying in the shadows as lobbyists, these powerful economic and financial entities should willingly accept such a possibility of being explicitly responsible and accountable for the universal Common Good.

The small steps proposed here will not immediately solve the conundrum of global financial and economic governance, nor will they establish a 'world authority'. That being said, they could help prepare the stage, or the scaffoldings which could be useful in the future, when the time for a world authority will be ripe.

❡ *Complexity, systemic risk, and systemic resilience*

The contemporary financial crisis has brought to the fore a notion that until now remained hidden: the idea of systemic risk. Systems are made of multi-layered interlocking networks of interacting elements. Complexity is inherent to any system: it means that in some circumstance the behaviour of the system become impossible to fully predict or determine because many feed-back loops interact while connecting the same elements. Thus, a system is much more that the simple aggregation of its components: interactions and their density matter more than the simple elements. The consequences of an event on a complex system are seldom determined by linear causality—they result from multiple, often parallel, interactions difficult to mastermind in advance or control in real-time.

The idea behind the notion of systemic risk is that of sudden vulnerability of the system due to a previously undetected weakness which may consist of a sequence of minor failures. In certain circumstances, an unusual sequence of interactions may abruptly put the survival of the whole system at risk. Systemic risk became suddenly visible when the web of interdependencies made the whole financial world tremble once Lehman Brothers was pushed into bankruptcy in September 2008. Suddenly, the whole world economy was at risk. Systemic risk has been described by mathematicians in what is known as 'catastrophe theory' which shows that in complex systems a priori non-significant events may have consequences that jeopardise the whole system. In simpler terms, systemic risk is also about the asymmetry between the acts (or gains) and potential damage that the behaviour of a few can inflict on the many. Systemic risk is the negative side of what Winston Churchill said about the heroic contribution of the Royal Air Force to the victory in the Battle of Britain: "Never in the field of human conflict was so much owed by so many to so few."

Systemic risk materialises when self-organising and self-stabilising loops and mechanisms derail and fail to maintain the internal coherence at a level necessary to keep the system working. Beyond this minimal level, if interactions break down or some elements get out of control, the level of coherence dwindles, and the very survival of the system is at stake. Systemic risk starts to materialise in areas where 'no one in charge', i.e. in places of organisational vulnerability or vacuum. These are also the places where ego-centric moral hazard naturally flourishes, the places where the unscrupulous or the merely unwise choose immediate returns over medium-term general collapse. These are also exactly the places where Common Good-centred decisions may make all the difference and contribute to systemic resilience.

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The question that arises when the notion of 'systemic risk' is applied to the financial context concerns the reasons that allowed the build-up of financial fragility to remain unnoticed—and thus unaddressed—for such a long time. There are plenty of highly technical explanations which stop short of answering the question posed by Queen Elizabeth at the London School of Economics and referred to in the introduction: "Why did no one see it coming?" Today two causes are widely recognised: on the macro-level, the lack of adequate diagnosis and the subsequent lack of a regulatory response framework; on the micro-level, 'excessive appetite for risk', meaning inadequate perception of risk, or more precisely an excessive self-centred appetite for returns despite the high risks—systemic and otherwise—involved.

In 2007 and 2008, the sudden evidence that 'no one is really in charge' took the world by surprise. The system was purposely left unattended for decades to its supposed self-regulating mechanisms. As shown in the first part of the report, at the time of the beginning of financial euphoria, a blind idealistic faith in IEE coincided with the exploitation by the US of a moral hazard advantage.

In 2007 and 2008, gigantic public emergency rescue operations came first, then the painful evidence started to converge showing that the way portions of the system were operating had little to do with its accepted representations. At that very moment, the decades of lack of political and intellectual realism were starting to take their toll. Banks proved more leveraged and weaker than thought, risk management methods more myopic and incomplete, the largest unregulated markets such as LIBOR or Forex less perfect and more rigged, shadow finance distorted by conflict of interest, regulators largely captured by the regulated, academics disconnected from reality and imprisoned in the IEE paradigm. Indeed, for decades, no one was in position either institutionally or intellectually to have the full picture of how the world financial system really operated.

"At that very moment, the decades of lack of political and intellectual realism were starting to take their toll. Banks proved more leveraged and weaker than thought, risk management methods more myopic and incomplete, ..."

Can systemic risk—i.e. systemic vulnerabilities—be mitigated when actors are unconstrained by a hierarchy or force? Two classical philosophical answers are available as discussed earlier: 1) the invisible hand of the efficient self-equilibrating markets; and 2) the shared concern for the Common Good leading to prudent, self-restraining behaviours with regard for 'the other'. In the first case discipline is external to every player, irrespective of what he does or attempts to do, and the pressure of the others intermediated by the markets will either force him to order or annihilate him. In the second case limits have to be set and enforced by the interior moral force of every actor.

Between the idealistic ideas of 'spontaneous markets' and the 'spontaneous strive for the Common Good', a third, intermediary position appears as a realistic avenue. The crisis has shown that mitigation of systemic risk requires both elements: the external discipline of markets and law, and a high moral stance and self-restraint of actors. In the years preceding the financial crisis, both elements were largely missing.

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Writing in 1948, François Perroux, an overtly Christian French economist, identified already that capitalism (in the sense of the free market economy) is not self-sufficient and needs to be supported by a moral framework which it will, paradoxically, tend to destroy. Perroux warned about this paradox in which he saw a congenital weakness of capitalism. He said the following:

> "A way of thinking that is prior and alien to capitalism sustains, for a variable period of time, the framework in which the capitalist economy operates. But owing to the latter's very expansion and success, inasmuch as it receives the esteem and gratitude of the masses and fosters among them a taste for material comfort and well-being, it undermines the traditional institutions and mental structures on which every social order depends.

> Capitalism erodes and corrupts. It consumes vast quantities of vital energy whose rise it does not control. Political leaders need a rare cool-headedness in their diagnosis, and an exceptional energy in administering the treatment, if they are to detect and ward off this ailment in good time.
>
> Not only does capitalism fail to supply the principles and resources for the political order that it needs, but its development threatens the requirements and techniques of political integration. Capitalism cares nothing for morality; yet all politics is based on morality, indeed metaphysics. Capitalism seeks unbridled freedom; yet no political society can be viable without intervention, restriction and balancing of freedoms. Capitalism benefits from breaking up natural communities and intermediate groups; yet no political organisation can be maintained or established without them. Capitalism cannot accept arbitration in the economic order; yet all political power is arbitration, and must not be excluded from any area of society."[68]

The challenge for the future is to rebuild again the forces of capitalism from outside (by regulations) and from inside (by virtuous behaviours). Some specific avenues and possible lines of action have been envisaged above. The question of 'how' remains however open. This concluding part offers a perspective on the inescapable systemic transformation.

Systemic transformation: Replacing structures of sin with structures for the Common Good

What is needed is a smooth systemic change from a system geared solely to efficiency towards a system geared toward the Common Good. As in most systemic transformations, change has to take place simultaneously at four different levels of the social system: at the levels of worldview, of institutions, of mechanisms, and of behaviours. At each of these levels, the Christian perspective inspires.

¶ Worldview

Caring for the Common Good requires a realistic—as opposed to an *a-priori*—worldview. Realism implies careful observation rather than deductive thinking, asking questions rather than jumping to conclusions, the capacity to take changes and new conditions into account, and to revise previous conclusions rather than hold to dogmatic rigidity. Realism is conducive to risk-taking in the name of charity and mercy, while idealism can at best deliver only blind justice.

The still-dominant economic theory and the management mantra are rooted in deductive thinking. They provide a powerfully coherent and aesthetically appealing framework for analysis and a reassuring inspiration for subsequent action. However, this IEE framework is built on assumptions which pretend to be approximations of the real world but are, in fact, fundamentally (not accidentally) and irretrievably counter-factual. Therefore, the construct of contemporary theory is part of an imaginary world, only loosely related to reality. Two consequences stem from this. On one side, policy makers and managers have to look for the sources of inspiration for their actions outside of the box of theory. By doing so, they have to take on the responsibility and the risk of forging new paths in the uncharted waters of reality. On the other side, the academic disciplines of economics, management, and finance have to urgently reconstruct themselves around the realistic premises of sound anthropology and its relationship to the Common Good[69].

¶ Institutions

The recent crisis has demonstrated—surprisingly to many—that institutions matter. They express, and by the same token condition, the normal patterns of behaviours and determine the related consequences. Formal or informal institutions are not immobile. They change because the formal legal structures change, but also because dominant patterns of behaviour change, usually as a result of a deeper change of cultural values. The relationship between institutions and individual behaviours is therefore two-sided. On one side, structures influence behaviours, but on the other side, exemplary and innovative patterns of behaviour may also change institutions. This happens every day[70].

Pope John Paul II introduced a moral dimension into the world of institutions when he used the notion of 'structures of sin'[71]. He used this term to describe man-made institutional settings which condition and incentivise other individuals—often in subordinate social positions—to wrongdoing or conversely to disincentivise doing good. Such structures have a strong leverage effect—they can be seen as 'multipliers' of behaviours across society. In the case of structures of sin, sinful behaviours are multiplied which may thereby have a major impact on the society as a whole. At the origin of such structures or institutions are individual sins—greed, pride/ egoism, or disloyal or untruthful aims—which then translate into specific organisational or legal structures. Through structures of sin, individual sins are turned into social ones.

Individual and group courage, virtue, and exemplarity are needed to prevent such structures of sin from emerging and to denounce, derail, and eradicate their actions where they exist already. The social multiplier at work in the 'structures of sin' may however be reversed and used with morally opposite consequences. The individual search for the Common Good (local and universal), concern for 'the other', and commitment to justice and equity, combined with courage and imagination put in motion at structuring moments, may help the emergence of new patterns of behaviour or even organisational or legal structures which then become 'structures for the Common Good'.

Such achievements may ultimately be consolidated by corresponding legal and institutional changes. At that very moment 'structures for the Common Good' may flourish and replace structures of sin. Where the latter were destroying trust and solidarity, 'structures for the Common Good' will leverage them. Once in place, such structures will act as enhancers and multipliers of individual efforts and give them a social dimension. Drops end up making oceans. Social habits—in the sense of morally good habits (*habitus*)—are those drops which end up wiping out mountains[72].

The only question is: how many will have sufficient courage and faith to dare to put the structures for Common Good in motion?

¶ Mechanisms and patterns

Abandoned to the overwhelming rule of the ethos of efficiency, today's world is sacrificing the seeds of its future fecundity for the sake of immediate results. By harvesting where we have not sown, all reserves and resources are being exhausted, including the future which has been in recent years massively pre-empted and mortgaged for the sake of the present. Any fecundity needs some obscurity, calm, and idleness, which amount to pure waste when looked at from the perspective of immediate efficiency. Fecundity is a promise, not a certainty, and as such has even less place in pure economic or financial reasoning. That being said, humanity and civilisation are paradoxically the fruits of the gratuitous fecundity of God's gift. A Christian perspective on economic and financial life has to underline that future fecundity requires that some resources remain today seemingly idle. As fecundity is not a contractual obligation, the necessary resources are put aside on the basis of sheer trust in promise, hope, or faith.

In everyday life, the tension between the requirements of efficiency and those of fecundity can be made clearly visible by contrasting transactions and relations. Efficient transactions in the IEE sense are moment of truce in the economic war of all against all. If transactions are anonymous and impersonal, quite the opposite is true for relations, which are by definition nodes of cooperation. Only when parties know each other personally and in their peculiarities might they enter a relationship. This means that most relations have a built-in dynamism, as opposed to self-contained and static transactions. If transactions are complete because they are built on equivalent exchange, then relations, by definition, are a succession of imbalances. By contrasting relations with transactions, the peculiarities of each form of social interaction clearly appear[73]. Transactions, by their commitment to instantaneous efficiency, deliver immediately everything which can be harvested at once. However, relations are the place of fecundity; they balance the fruits of past efforts with the seeds of future results.

The important question of our times is to restore the adequate proportion between these two forms of social interaction. In the efficiency-driven world, much of what until recently was a matter of relationships is today either a matter of market or of administrative transactions. Although the situation may seem different in much of the developing world—where Market and State do not function fully—the trend of breaking relationships is universal, especially in urban centres. Deepening asymmetries, growing exclusion, and inequalities are largely by-products of the social fabric of relationships falling into pieces under the pressure of transactional individualism geared to the overall quest for efficiency. The issue is thus not to ban or condemn transactions as such, for they are necessary. Rather it is to mind the appropriate proportion and balance between the two. A purely transactional world of IEE is inhuman, but the totally relational society—closed society or sticky society—may also be dangerous and potentially perverse.

Christian tradition and teaching is articulated around the vision of man as a 'relational' being who is unable to survive on his own. Man needs to be in constant relationship with God and his brothers and sisters, showing that, even though transactions may play an important role, this role will be merely instrumental with respect to the existential character of relations. In this sense, the present crisis can be seen as a rebellion of human nature against the excessive role played by transactions. The Christian proposition may therefore be summed up as a call to restoring the pre-eminence of relations over subservient transactions in every sphere of life, including financial and economic life.

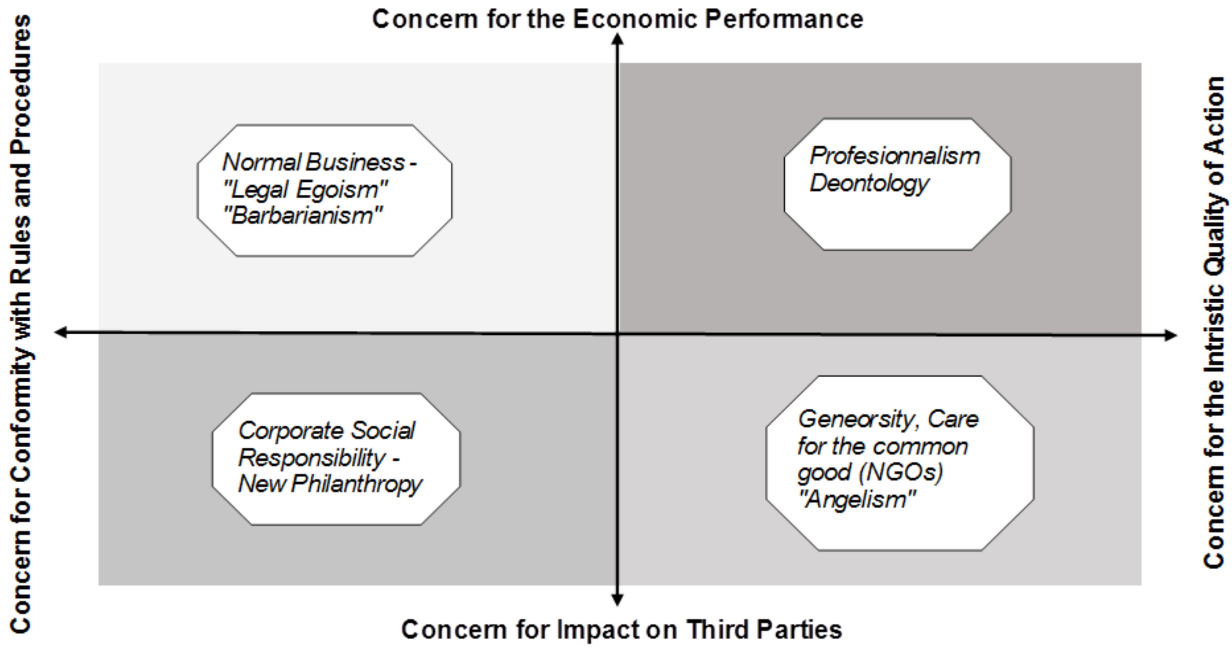
In order to prepare for the future, the idle reserve resources needed for fecundity—in the metaphoric sense—have to be restored. For the time being, most of the available resources are engaged in a global just-in-time economic carousel. In order to free some of these resources, including time, limits have to be set as to the extent of purely transactional dealings geared toward immediate efficiency. Social as well as individual emphasis must shift from transactions and immediate efficiency to relations and medium- or long-term fecundity. Such shift requires that the incentives—not only material and monetary, but also moral—be developed to encourage long-term commitments in all areas of the economy and the financial sector.

Such changes have to take root in groups—families, associations, and companies—before they will reach the social level. Rediscovering relations means changing the dominant patterns of social and economic interaction to progressively instil adequate habits. Here again the notion of *habitus*—virtuous habits—embedded in corporate cultures, family traditions, or even in social ethos all have their meaning. Ethics and socially virtuous habits may be both the cradle and the consequence of structures for the Common Good. Ultimately, neither structures for the Common Good nor relational habits will appear unless adequate decisions and actions are made at all levels of society.

❡ Decisions and behaviours: Moving from here to there

Social systems function or fail to function because of infinite numbers of daily micro-decisions. The majority of these decisions are trivial and automatic but few can be called 'defining moments' because they leave a mark either on the decision maker himself or on the context in which he acts[74]. As mentioned above, behaviours and individual decisions may initiate major systemic changes by destroying powerful structures of sin and replacing them with structures for the Common Good. Such were

Figure 16: Informed decision framework[75]



the examples of Gandhi, Mandela, or Walesa. The key commonality of such behaviours is that they are focused not only on outcomes—unpredictable in all three cases—but on the moral quality of action.

The never-ending pursuit of virtuous behaviour should be at the very centre of the Christian life. The four cardinal virtues of prudence, justice, fortitude, and temperance are mutually reinforcing and complementary. They provide the necessary tools for action to anyone who cares about the Common Good and is willing and ready to take risks in its name. Virtues are a call for commitment and risk taking for the Common Good in both its earthly and its transcendent dimensions. In fact, the call for virtuous action is reinforced for Christians by the three theological virtues: faith, hope, and charity (love). Jean-Loup Dherse used to say that cardinal virtues suffice to make man feel responsible for the co-creation of the world (the earthly dimension of the Common Good), but only when man is animated by the theological virtues is he or she able to take responsibility in co-redemption (the transcendent dimension of the Common Good)[76]. And that is what the Christian Common Good is ultimately about.

Virtuous behaviours imply a balance between the assessment of consequences and the intrinsic moral quality of the act. This last dimension is tantamount to moral risk-taking which theological virtues may inspire. Each of these dimensions has two possible polarities: either it is self-centred or it is group- or society-centred. For actors behaving in the realm of economic and financial activities, the self-centred impact will be measured by what may be called 'economic performance' measured at an actor's level by a given metric. The group-centred impact will be assessed at the social level.

When it comes to the intrinsic moral dimension of an act, the self-centred point of reference will be the internal moral standard, while the social reference will be provided by the measure of 'compliance' either with law or with a local procedure.

Figure 16 provides a graphic presentation of these two dimensions. The N-S axis represents the impact dimension, while the E-W represents the moral quality dimension. While the vertical dimension refers more to the material consequences of actions—a consequentialist approach—the horizontal one captures the virtue load of a decision or action. The graphic presentation suggests that what is at stake is the importance of achieving balanced decisions. This is especially difficult in the context of economic life where performance is the ultimate target, and compliance the unique constraint. The graph reminds that the concern for others—for justice and equity—has to be part of every decision inspired by Christian values. The same is true for the moral quality of the action.

Unlike efficiency-driven econo-centric behaviours prescribed by IEE, ethical behaviours will care about the impact of decisions not only on oneself but also on 'the other'. Taking responsibility and being accountable to others and to the Common Good is rooted in concern for ethics and justice. The urgent systemic transformation which this paper has described in its main components can be achieved smoothly only if behaviours inspired by the care for the Common Good outweigh those geared exclusively toward pure efficiency; if networks of relationships based in multidimensional reciprocity regain some advantage over efficient transactions; if structures of sin are substituted by structures for the Common Good. But all these changes require as a condition that human minds free themselves from the seductive promises of the golden calf.

Notes

1. The authors would like to thank the Caritas in Veritate Foundation for giving the opportunity, and also the challenge, to align their philosophical and analytical views on the crisis, on the state of economic knowledge and—more broadly and importantly—on the required lines of action. During the (long) process of elaboration, the authors have greatly benefited from taking active part in many more or less technical conferences and debates on issues touched upon in this report. In the context of Catholic Social Teaching and the financial crisis, four such especially enriching meetings deserve particular mention: *Banking on the Common Good, Finance for the Common Good,* organised by the Pontifical Council for Justice and Peace, Vatican, 12–14 May 2013; *Christian Social Teaching: A Source of Inspiration to Address the Crisis of the Binary Model of Market-plus-State*, Association Internationale pour l'Enseignement Social Chrétien, Canterbury, 23–25 August 2013; *Beyond Financial Crisis—a Catholic Perspective*, Caritas in Veritate Foundation, United Nations in Geneva, 20 September 2013; *The Debt Crisis, Financial Reform and the Common Good*, Fondazione Centesimus Annus—Pro Pontifice, Vatican, 27–28 September 2013. In the early stages of elaboration, the research assistance of Pierre Bernard at the Observatoire de la Finance was mostly useful. In later stages, the text has greatly benefited from critiques, remarks, and suggestions of friends who accepted to review it. Our warmest thanks go to Don Patrick de Laubier; Edouard Dommen; Francois-Marie Monnet; Mathias Nebel; Etienne Perrot, SJ; Domingo Sugranyes; Marc Surchat; Ernesto Rossi di Montelera; and Rt Hon Justin Welby, Archbishop of Canterbury. Notwithstanding these generous contributions, the opinions and analysis contained in this text are those of the authors.

2. Figure 1: British Academy for the Humanities and Social Sciences. Available at https://www.britac.ac.uk/news/newsrelease-economy.cfm (accessed 22 April 2014).

3. Under the classical Gold Exchange Standard, internal money supply is mechanically linked to the amount of gold held by the central bank. In cases of external current account deficit, gold holdings of central banks are used for settlement. This reduces internal money supply and may feed deflation which in turn may stimulate exports and help to achievine external balance but may also trigger recession.

4. In doing so, Nixon said the US was acting to limit their growing current account deficit, to increase their international competitiveness, and to be better prepared to provide jobs for their GIs returning from Vietnam. The US decision can be seen as a devaluation of the dollar in terms of gold, and subsequently in terms of all other currencies.

5. This decision was breaking with the *pacta sunt servanda* principle, at a time when the spirit of international cooperation in monetary and economic matters was fading away because of increasingly conflicting economic interests between the major IMF members.

6. For the UK, the pending imperial problem was of sterling balances convertible into silver, not gold.

7. Figure 2: Authors' calculations; primary data: *Triennial Central Bank Survey*, Bank for International Settlements, September 2013. Available at https://www.bis.org/publ/rpfx13fx.pdf (accessed 22 April 2014).

8. Figure 3: IMF; authors' calculations.

9. Figure 4: IMF; authors' calculations.

10. Figure 5: *Price formation in financialized commodity markets: the role of information*, UNCTAD, 2011. Available at http://unctad.org/en/docs/gds20111_en.pdf (accessed 22 April 2014).

11. Figure 6: *World Economic Situation and Prospects 2013*, UN Department of Economic and Social Affairs, 2013, p.48. Available at http://www.un.org/en/development/desa/policy/wesp/wesp_archive/2013wesp.pdf (accessed 22 April 2014).

12. Between 1948 and 1999, tariffs on merchandise trade has been reduced by an average of 83%. *Facts for the 'Fifth'*, World Trade Organization, 2003. Available at http://www.wto.org/english/thewto_e/minist_e/min03_e/brief_e/brief24_e.htm (accessed 22 April 2014).

13. Stephen Cecchetti, *Global imbalances: current accounts and financial flows,* Remarks prepared for the Myron Scholes Global Markets Forum University of Chicago, Bank for International Settlements, 27 September 2011; Stephen Cecchetti, *Five years in the tower*, Remarks prepared for the 12th BIS Annual Conference Lucerne, Switzerland, Bank for International Settlements, 20–21 June 2013.

14. Figure 7: Authors' calculations. Primary data: OECD and Banque de France.

15. Figure 8: Authors' calculations. Primary data: Thomson Financial.

16. One of the cornerstones of modern finance, both corporate and market, the theorem was developed by the brilliant minds of Nobel laureates (F. Modigliani in 1985, M. Miller in 1990) in a demonstration carried out in a perfect world of models.

17. Simona Beretta & Mario Maggioni, *'The whole breadth of reason': a step towards rethinking economics and rationality*, REVISTA INTERNAZIONALE DI SCIENCE SOCIALE 3, 2012, pp. 241–62.

18. A parallel shift in power has affected relations between governments and markets. The ongoing debt crisis, also nick-named the €uro-zone crisis, sheds full light on the 'opinion making' power of ratings agencies and the pressure they are able to exert on the design and implementation of economic and fiscal policies by supposedly sovereign governments. Here again an asymmetry has been growing between the real life of internal politics and social demands and the judgments and expectations of external financial markets anxious to preserve the interests of the 'world's wealth'.

19. Figure 9: Authors' calculations. Primary data: OECD and Banque de France.

20. Figure 10: Authors' calculations. Primary data: OECD and Banque de France.

21. *81st Annual Report*, Bank for International Settlements, 26 June 2011.

22. As mentioned earlier, the euro-dollar market took on a global role in the late 1960s, and after 1971 the forex market followed. Despite the fact that it is today the biggest by volume of all markets, the forex market is non-regulated. The second by size is the also-unregulated OTC (over-the-counter) derivative market where the notional value of transactions is close to 7–8 times gross world product.

23. Figure 11: Authors' calculations. Primary data: Thomson Financial.

24. *G20 Leaders' Declaration*, September 2013, p. 4.

25. *79th Annual Report*, Bank for International Settlements, 29 June 2009, p. 14.

26. Figure 12: Authors' calculations. Primary data: World Bank, Global Development Finance 2013.

27. Alex Cobham et al, *Estimating Illicit Flows of Capital via Trade Mispricing: A Forensic Analysis of Data on Switzerland*, Centre for Global Development, 2014. Available at 2013-Cobham-illicit-flows-switzerland_0.pdf (accessed 22 April 2014).

28. Paul H. Dembinski, ECONOMIC AND FINANCIAL GLOBALISATION: WHAT DO THE NUMBERS SAY? Geneva & New York, 2003.

29. Figure 13: Authors' calculations. Primary data: World Bank.

30. Figure 14: Authors' calculations. Primary data: World Bank.

31. China being the only—albeit significant—exception.

32. Figure 15: Authors' calculations. Primary data: World Bank.

33. Joseph Stiglitz, THE PRICE OF INEQUALITY, New York & London, 2012, p. 400; Oxfam. Inequalities are also growing within the wealthiest countries. This point is stressed

by many recent reports.

34. Mathias Nebel, *Servir les pauvres—Oui, mais dites-moi: quels pauvres au juste?*, Revue de Théologie Morale, June 2014.

35. The general debate about trade-offs has been going on for a long time and is largely inconclusive. That being said, the way of addressing the trade-off problem in consequentialist and utilitarian terms is problematic for a Christian approach based on values such as equity and justice. In a recent interview to *Corriere della sera* (5 March 2014), Pope Francis said that values cannot, by definition, be negotiated: "*I valori sono valori e basta, non posso dire che tra le dita di una mano ve ne sia una meno utile di un'altra. Per cui non capisco in che senso vi possano esser valori negoziabili*." For this very reason and despite its intellectually challenging character, pure theorising about trade-offs limited by model-driven idealism does not make much sense as it will necessarily be only technical or quantitative. On the contrary, what ultimately makes sense is a back and forth movement between abstractions which may provide guidance, and realities—including moral ones—in which action is inescapably located. In this way knowledge is enriched but also checked by real-life experimentation.

36. The concept of efficiency may be used in many different contexts: technical efficiency relates to specific physical inputs or physical units of output; economic efficiency is usually expressed in terms of profit-and-loss account; the modern concept of financial efficiency is commonly measured in terms of the 'return on investment' (ROI).

37. It is important to stress that nothing can be inferred regarding the equity dimension of a *Pareto-efficient* distribution of income. Both *allocative efficiency* and *Pareto optimality* (together with instrumental micro-economic efficiency) are the joint outcomes promised by the theory of perfect competition which serves as the ideal reference point to most of the still-dominant paradigm of economic theory (and the analysis rooted in it) geared to maximisation of satisfaction and of efficiency.

38. General equilibrium models are only able to show how equilibrium is restored after some kind of external shock, but not how efficient equilibrium is reached from scratch. In order to move the world from one state to another, models usually require a change in assumptions, which in the real world means political intervention.

39. Thomas D. Williams, *Global Governance and the Universal Common Good*, Alpha Omega 13(2), 2010, pp. 272–73 (emphasis original); Etienne Perrot, Discerner et agir dans la vie professionnelle. Paris, 1992: "*Le bien commun est le bien de la communauté. Communauté dit davantage que collectivité. La communauté est l'union, dans un même corps, d'individus libres. Le bien commun implique donc non seulement le respect du corps social—ce qui vise déjà l'intérêt général—mais encore le respect de la dignité de tous et de chacun.*"

40. *Compendium of the Social Doctrine of the Church*, 164, 170.

41. Williams, supra note 30; the Common Good is not a fragile institutional construct, as it depends on the daily deeds of actors which by definition are free. Each generation is free to discard or to deepen its moral and institutional heritage.

42. Paul H. Dembinski, *Finanzen und Fristen: Krise der Kongruenz zwischen Realität und Virtualität der Zeit*, in Religion-Wirtschaft-Politik: Vol. 8. Kapitalismus – eine Religion in der Krise I. Grundprobleme von Risiko, Vertrauen, Schuld, eds. G. Pfleiderer & P. Seele, pp. 282–322, Zürich, 2013.

43. Within the economics discipline, many attempts are under way to change the underlying anthropological model. This is especially true in so-called 'behavioural' economics and finance. Despite all these efforts, for the time being only *homo oeconomicus* is fit to operate the flagship of IEE. This shows, to put it differently, that the IEE construct is totally dependent on its anthropological assumptions. Once these are questioned, the whole construct falls apart.

44. *Compendium of the Social Doctrine of the Church*, 580–83.

45. Benedict XVI insisted heavily on the role of relationships in social life when he wrote in his only social encyclical *Caritas in Veritate* in 2009 (53): "Thinking of this kind requires a *deeper critical evaluation of the category of relation*. This is a task that cannot be undertaken by the social sciences alone, insofar as the contribution of disciplines such as metaphysics and theology is needed if man's transcendent dignity is to be properly understood."

46. Paul H. Dembinski, *Fecundity vs. Efficiency: Rediscoveing Relations,* in Humanism in Business Series. Human Development in Business. Values and Humanistic Management in the Encyclical "Caritas in Veritate", eds. D. Melé & C. Dierksmeier, pp. 98–116, UK, 2012.

47. *Caritas in Veritate* (37) is crystal clear about this: "The Church's social doctrine has always maintained that *justice must be applied to every phase of economic activity,* because this is always concerned with man and his needs. Locating resources, financing, production, consumption and all the other phases in the economic cycle inevitably have moral implications. *Thus every economic decision has a moral consequence*."

48. Mt. 6:24-34, Lk. 16:13.

49. N. Acatrinei, Saint Jean Chrysostome et l'homo oeconomicus: Une enquête d'anthropologie économique dans les homélies sur l'Evangile de St Matthieu, 2008.

50. J. Ellul, L'homme et l'argent. Paris & Neuchâtel, 1954.

51. F.-M. Monnet, Luc, XVI ou l'économie du royaume, 2012.

52. Pope Francis, *Evangelii Gaudium,* 55–57.

53. Bénédict Winiger, Verantwortung, Reversibilität und Verschulden. Tübingen, Germany, 2013.

54. V. Forrester, L'horreur économique. Paris, 1996.

55. Solidarity may also be called "the search for equality." Arthur Okun, Equality and Efficiency: The Big Tradeoff. Washington DC, 1975.

56. Mt 20:1-16.

57. This view overlooks two important things. First that sharing and solidarity contribute to building strong communities and have a moral dimension. Second, that in complex modern enterprises the effective contribution to production cannot be unequivocally assessed; every such calculation depends heavily on measurement methods and the accounting assumptions used.

58. P. de Woot, Repenser l'entreprise: Competitivite, technologie et societe: Rendre à l'action économique ses dimensions éthiques et politiques. Brussels, 2013; This issue has also a general meaning as it questions the legal status of the corporation as a 'moral person'. Under the veil of 'moral person' the corporation is reduced to a 'nexus of contracts', but the enterprise may lose its ontological essence of community. Within the nexus of contracts which makes up a modern corporation, asymmetries of all kind easily flourish. Justin Welby, *Can Companies Sin? "Whether", "How" and "Who" in Company Accountability*, Grove Ethical Studies 85, 1992.

59. It is worth stressing that, in the Christian perspective, the common good of an enterprise cannot be reduced to the sum of interests of stake-holders as the stakeholder approach would suggest. 'Common good' encompasses stakeholders as parties to a whole larger than the sum of its parts. The asymmetry between financial capital and other components of enterprises can also be reduced by strengthening the co-responsibility of shareholders and workers for its common good. It should be done by limiting the flexibility (volatility) on the capital side, while increasing flexibility—in parallel—on the labour side. Indeed, to equalise the relative strength of forces at work in modern enterprises, an aggiornamento—a foundational rework—is needed on two sides: on the industrial relations side involving trade-unions and labour market reforms, and, in parallel, on the

corresponding financial relations side involving capital providers and financial markets. These measures which focus on the level of the enterprise, on top of classical interpersonal solidarity, would contribute to a deeper co-responsibility between the world of finance and the so-called real economy of productive activities.

60. Paul H. Dembinski, Pratiques financières—regards chrétiens. Paris, 2009; Because of the unavoidable asymmetry of debt contracts, the official stance of the Catholic Church on practices such as use of interest and its levels, is still rather cautious. Similar questions have been discussed by Jewish as well as Muslims scholars.

61. J.-M. Bonvin, Debt and the Jubilee—Dette et Jubilé, Observatoire de la Finance. Geneva, 1999.

62. Neither the WTO nor the G20 mention global competition policy in their recent documents.

63. This principle could be extended to the internal organisation of a company: worker autonomy, subsidiarity within the firm, industrial relations, etc.

64. Biéler, La pensée économique et sociale de Calvin. Geneva, 1961/2005.

65. The trend toward a further extension of intellectual property rights has set the stage for the creation of new financial assets and related royalty payments (often to affiliates of global giants located in offshore centres) and has reinforced the competitive advantage and market power of owners. The typical economic argument defends these trends by saying that they are necessary to promote innovation in the name of progress and growth. In the Christian perspective of the universal Common Good, does the enrichment of the few justify the exclusion of the many? Even if the overall outcome is positive in terms of additional national income, can efficiency gains be justified when they impair the autonomy, creativity, and fecundity of the weakest? It may well be the case today that because of the recent proliferation of intellectual property rights together with the increased arsenal of technical and legal enforcement instruments, it may well be that the value of immaterial counter-parts of financial capital corresponding to these immaterial goods is in the same range as the value of material or physical goods on companies' balance sheets. As mentioned above, global giants are especially inventive in this field. M. Boldrin & D. K. Levine, *The Case Against Patents*, Journal of Economic Perspectives 27(1), 2013, pp. 3–22.

66. A symmetric argument could be developed from the point of view of users who—in many cases—lose their freedom as they are artificially 'enslaved' to a specific functionality of a product or a service. This is often the case in high-tech products or packages where incompatibility is often an artificially built-in limitation. Once captured in a dependency relationship, the client becomes—in the accounting sense—an element of the company's goodwill and thereby its financial asset.

67. The principle of the universal destination of goods is hard to transpose, as such, to the world of immateriality where scarcity is only a legal and social construct. Its application would require on one side the stratification of access rights for different groups of users according to their material condition, and on the other side, also an extended control to limit abuses in the handling of these stratified rights. Paradoxically then, differentiated access rights which could be in line with a narrow reading of the universal destination of goods, could well require an increased control with a corresponding loss of autonomy of the least well-off.

68. F. Perroux, Le capitalisme. Que sais-je? Vol. 315. Paris, 1948.

69. This task is being taken up by groups of scholars in different parts of the world. *See* The appeal of teachers and researches: Renewing the research and teaching in finance, economics and management to better serve the common good, available at http://www.obsfin.ch/FR/Appeal.html (accessed 22 April 2014).

70. Nebel, supra note 25.

71. J. Bichot, *Sollicitudo rei socialis: finance et structures de péché*, PRATIQUES FINANCIÈRES—REGARDS CHRÉTIENS, Paul H. Dembinski, ed. Paris, 2009, pp. 59–87.

72. P. Nickl, *Habitus—Bemerkungen zu einem vergesenen Begriff*, HABITUELLE UNTERNEHMENSETHIK VON ETHIK ZUM ETHOS, Ulrich Hemel et al, eds. Baden-Baden, Germany, 2012, pp. 51–63.

73. This however does not authorise any all-encompassing moral judgment. In the real world, these two forms of social interaction co-exist and may be related to the Common Good. The important difference is that transactions are just instruments while relations require a personal involvement and therefore carry with them a moral (either positive or negative) load.

74. Joseph L. J. Badaracco, DEFINING MOMENTS: WHEN MANAGERS MUST CHOOSE BETWEEN RIGHT AND RIGHT. Boston, 1997.

75. Figure 16: *Mind the Gap*, Observatoire de la Finance.

76. J.-L. Dherse & H. D. Minguet, ETHIQUE OU LE CHAOS? Paris, 1998.

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SECTION TWO

RECENT CHURCH TEXTS ON THE FINANCIAL CRISIS

REACTIONS TO THE FINANCIAL CRISIS BY THE PONTIFICAL MAGISTERIUM: REVIEW AND INTRODUCTION TO THE TEXTS

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❡ *General remarks*

Considering the importance of the financial crisis, we might be surprised to find relatively few documents on the subject. Apart from the hurried document issued by the Pontifical Council for Justice and Peace in 2011, we can only rely on a quite limited set of texts and interventions by popes and nuncios at the UN both in New York and Geneva. On the one hand this is to be expected, yet on the other hand this does not do justice to reality. First and foremost, finance is not among the topics usually addressed by Catholic Social Teaching (CST). A lack of understanding of the functioning of complex financial architecture and probably some underestimation of their growth and importance over the last three decades certainly explains why the Catholic Church has not addressed the topic more forcefully. But the official interventions are only the tip of the iceberg. Not reproduced here are the many letters, recommendations, and interventions by popes, bishops' conferences, or Church committees to political leaders, international organizations and civil society leaders.

Most of these omitted documents are letters asking leaders to rise up to the crisis and dare to tackle its ethical dimension. On the level of personal behaviour: exalted greed, dishonest behaviour, lack of responsibility; on the level of government and international institutions: lack of proper regulation, no place for the common good in finance. But mainly, bishops ask politicians and leaders to see to the poor and the more vulnerable. They plead not to cut social programs, to tackle the 'new poor' near and far that the crisis has created—those dealing with unemployment, loss of homes or food programs, displacement through migration, and so forth. In one word they plead with the leaders to help the victims of the crisis; those who have lost everything to it. On this second level the Catholic Church has been very active indeed, especially through its own many relief agencies around the world. These may be in fact the most real answer given by the Church to the crisis.

However, as we are dealing here with the financial crisis at the level of ideas, this introduction shall focus on the texts issued by the pontifical magisterium on the financial crisis, trying to see how the social tradition of thought of the Church could be extended and applied to this crisis. Without much surprise, we find more general and elaborated answers in Benedict XVI's encyclical *Caritas in Veritate* and Francis' apostolic exhortation *Evangelii Gaudium*, as well as in the Justice and Peace document '*Toward reforming the international financial and monetary system in the context of global public authority*'.[1] Then there are several smaller addresses by the Holy See at international agencies that are more specific, but also more creative and practical. The encyclicals articulate the longstanding principles of CST applicable to the crisis; the addresses are more concerned with the consequences of the crisis and its victims far and near. Indeed, the nearer we get to the actual people affected by the crisis or dealing with it, the more the passion we see in the writing. Humanitarian urgency—the need to help the poor—becomes the main intention of the writer.

❡ Analysis of pontifical documents

The two popes, as would be expected, do not venture into the realm of practical action, but stay at the level of the root causes of the crisis. Almost every document follows what could be called a basic pattern of argument. They usually begin with a *summary analysis* of the financial crisis, then go on to state that self-regulation has not worked and reform is necessary. They then turn quickly to signal the moral roots of the crisis, lambasting greed, risk taking, lack of prudence, dishonesty, and *laissez-faire* policies and starkly remind that to function, financial markets must not be separated from ethics. A free market economy, for all its rightful autonomy, must serve the common good if it is to fulfil its social utility. As a third and last step in this basic pattern, the popes then appeal to the States or international agencies to address these root causes, reform financial markets, and enforce regulation on its actors. Responsibility for the common good and solidarity rather than exclusion shall be the criteria of this reform. Care for the poor and the vulnerable must be of special concern as they are the first victims of the crisis.

This basic pattern uses terms and criticisms that are not new and will be familiar to most readers. I thus do not intend to detail the argument for why the free market has to serve the common good or why greed cannot be the criterion for wealth creation, but will instead focus on some of the more original features that were brought up by the two popes on the topic of the financial crisis. Here are some of these features:

1. ***The self-regulation of financial markets has dramatically failed***. Both Francis and Benedict are adamant. There is a need to reform and regulate financial markets; to bring political and ethical governance to international finance. This means to stop making the assumption that market freedom is tantamount to an absence of regulation. A free market economy requires ethics and

political governance if it has to remain free. The economy must serve the human community and not be a mere disconnected instrument of wealth creation. The crisis is a stark reminder in the eye of both popes of the need for ethics. The wide disruption and suffering brought by the financial crisis on the economy and the society, especially the poor, clearly shows the consequence of refraining from exerting governance over modern financial flows.

2. ***The trickle-down effect is an illusion***. Pope Francis has one of the starkest condemnations of the notion that wealth creation will per-se ultimately reach the whole society. Empirical experience and research prove that increased wealth creation tends to enhance extremes, not to reduce them. While wealth concentrates on one end, on the other end vast numbers of people get progressively excluded from the economy, affecting their very survival. Financial markets—through the crisis—are seen as paradigmatic of a system of wealth creation that works against the poor and against humanity.

3. ***At the root of the economy there is a logic of gift and reciprocity***. Perhaps one of the most interesting and moving elements brought by Pope Benedict in the debate is that gift and reciprocity matter in financial markets. His argument runs along the following lines: The crisis was one of trust between institutional lenders. When even in the short term, forecasts could not be made based on the trustworthiness of other actors, engaging in reciprocal activity did not make sense anymore. The collapse of confidence was also the collapse of financial activity. Thus under the logic of reciprocity, another logic is at work that allows the former to exist. Gift and reciprocity, so says Benedict, are the twin elements of the basic grammar of love that creates trust in relationship and thus enables stable, long term interactions. Complex societies like ours tend to take trust as a given, something that simply exists and allows for the smooth functioning of our institutions. The financial crisis laid bare that the logic of the market—the logic of exchange, reciprocity, and contract—rests on the deeper logic of gift without counterpart that looks for trust to exist between social actors.

4. ***International financial markets require new forms of responsibility and solidarity***. This is another constant element of Benedict's thought on the crisis. The starting point is the following: the growth of international finance in the past decade has deeply altered the power of States. It has put objective limits on their sovereignty, specifically over their domestic economies. This trend is however not seen by the Pope

as something merely negative, since he seems to understand sovereignty rather as a responsibility. Confronted with the loss of national governance over the economy, Benedict XVI says we ought to find new, creative ways to fulfil the responsibility to protect that defines sovereignty. In keeping with the dynamic of the universal common good, he sees sovereignty more as a dynamic reality. The notion of sovereignty is not limited to a notion so greatly linked to the Nation-State and exclusive control of a territory and a population. International financial markets show how the responsibility to protect is now a shared reality that can only be tackled together or not at all. This is the main narrative that drives him to mention the need for a global political authority. However, the responsibility to protect is broader in Benedict's usage than in its international definition. It is a responsibility we have toward future generations and a responsibility we bear for the poor and the vulnerable. He spells out four dimensions of responsibility in one text: responsibility toward ourselves, responsibility toward other nations, responsibility for our common world, and responsibility for the other who suffers.

5. ***Financial crisis and the need for a world political authority***. With the financial crisis in mind, Benedict XVI argues that the case for a global political authority is stronger than before. This should not be an authority imposed by anyone, but freely seen as a necessity by all nations and commonly agreed with respect for subsidiarity. It should seek and serve the common good and have the means to enforce its governance, but not to impose it against the will of any member. It should be a political as well as a moral rule. Clearly enough, much more than a specific political system, the Pope points here to the practical need emerging in a globalised world for stronger governance bodies that will not leave forces that exceed Nation-States without political and moral governance. The world political authority being directly linked to the search of the universal common good, it belongs to the eschatological horizon toward which we are meant to work but will not reach but at the end of time.

These five points, once brought back to the debate on the root causes of the financial crisis, open new perspectives on the question. But besides their direct, personal interventions on the matter, the Holy See also has repeatedly taken position on the crisis. These interventions precede and complete the ones made by the popes.

❡ Interventions of the Holy See at the UN

Among the interventions of the Holy See, a special mention must be made of the ones at the UN. They are by nature more sensitive to the place and timing of the address and must therefore be understood in the context of the discussion at the time.

The first follows the immediate aftermath of the 2008 onset of the crisis and was given at the UN General Assembly by Msgr Migliori. The document still glows with the first outrage toward the unfolding crisis. The Holy See lambasts the "disregard for regulatory and supervisory structure and the contempt for accountability rules and transparency" and the lack of a "complete and effective regulatory system." However, the crisis is already seen not as merely technical but having an ethical root: the collective failure of the *social responsibilities of corporations and public institutions* regarding international finance. The crisis reveals the negatives of the *social function* of corporations and public institutions in the market and therefore the *shared duties* they have toward the common good. The intervention outlines three major failures:

1. ***Failure of banks, governments, and international financial institutions to enforce at the highest level the rules they implemented at lower levels***. Developing countries, ordinary citizens and bank consumers were submitted to hard scrutiny whereas developed economies, governments, and bank management were lax in their own administration.

2. ***Failure to exert prudent governance for the common good***, especially from government and banks. "Government is the exercise of the virtue of prudence in the enactment of legislative and executive measures capable of directing social activity toward the common good" (2008/10). Excessive risk taking by bank management and sheer ignorance by government of the systemic risk was created by large under-regulated financial institutions to the society.

3. ***Failure of the general public to resist an economic system based on increased and uncontrolled consumption***. Not only is the trend unsustainable, but also offends the dignity of the consumer as a rational creature and the dignity of others.

Some months later, in December 2008, a second intervention was made by Msgr Migliori at Doha as a follow up to the 'Monterrey Consensus on Financing for Development'. The point made by the document is that in the same way that we have developed an approach to development as having to be sustainable, we should now see and seek *sustainable finance*: "sustainable financing should meet the present capital needs for development, while ensuring the long term preservation and increase of resources. It is time […] to reaffirm the principle of sustainable financial development, apply it to financial markets and thus create truly sustainable capital management" (2008/12). Lending is a necessary social activity connecting savings to production and must remain at the service of production if it wants to remain reasonable. "If lending is seen merely in terms of trading off financial resources without regard for their reasonable use, it fails to be a service to society" (2008/10). Moreover, financial stability and security is a social good that drives job creation, stable fiscal revenue, and long term growth. Therefore, governments should see as one of their priorities to guarantee such stability and security.

The two statements made by Msgr Tomasi were made at the Human Rights Council in Geneva in 2009 and 2010. Therefore they tackle the crisis through the lens of human rights protection and look mainly to the negative social impacts of financial market failure. The crisis has cut millions of jobs, pushed an additional 53 million people below the threshold of $2 USD a day, threatens MDG achievement, and is a serious threat to international peace. The poor bear the brunt of the crisis, usually a distant victim of a crisis far from the actual financial markets.

The imbalances created by the crisis are caused, says Msgr Tomasi, when economic action a) is seen merely as an engine for wealth creation; b) is detached from political action and justice. "To engage in financial activity cannot be reduced to making easy profits, but also must include the promotion of the common good among those who lend, those who borrow and those who work" (2010). Free financial markets should be framed by solidarity, justice, honesty, and the principle of 'reciprocity and gift'.

Most interestingly, the Holy See states that the focus of concern in the reform of the financial system "should shift from goods and services to the persons who are the recipients of these services" (2010). The question is not one of techniques but of what becomes of human beings in financial markets. By giving priority to human beings, says Msgr Tomasi, we can "modify the rules that govern the financial system to serve concrete change" (2010).

❡ *Conclusion*

As seen before, the texts are fragmentary in nature and may disappoint people who would have expected a more solid argumentation from the Church. But easy condemnations are more often than not the signs of superficial analysis. The complexity and gravity of the crisis was not grasped immediately nor was an analysis ready-made to apply to the case in CST. Rather the contrary. As the documents show, there is indeed very little done in CST on the specific nature of financial assets, international financial flows, and financial market exchange. Much could and actually should be said. The present report intends precisely to engage the question of a Catholic perspective on what has happened and what is now unfolding as the landscape emerging 'beyond the crisis'.

NOTES

67. This document is not reproduced herein. Available at: http://www.vatican.va/roman_curia/pontifical_councils/justpeace/documents/rc_pc_justpeace_doc_20111024_nota_en.html (accessed 22 April 2014).

CARITAS IN VERITATE

POPE BENEDICT XVI

29 June 2009

¶ Fraternity, Economic Development and Civil Society

In a climate of mutual trust, the *market* is the economic institution that permits encounter between persons, inasmuch as they are economic subjects who make use of contracts to regulate their relations as they exchange goods and services of equivalent value between them, in order to satisfy their needs and desires. The market is subject to the principles of so-called *commutative justice*, which regulates the relations of giving and receiving between parties to a transaction. But the social doctrine of the Church has unceasingly highlighted the importance of *distributive justice* and *social justice* for the market economy, not only because it belongs within a broader social and political context, but also because of the wider network of relations within which it operates. In fact, if the market is governed solely by the principle of the equivalence in value of exchanged goods, it cannot produce the social cohesion that it requires in order to function well. *Without internal forms of solidarity and mutual trust, the market cannot completely fulfil its proper economic function*. And today it is this trust which has ceased to exist, and the loss of trust is a grave loss. It was timely when Paul VI in *Populorum Progressio* insisted that the economic system itself would benefit from the wide-ranging practice of justice, inasmuch as the first to gain from the development of poor countries would be rich ones. According to the Pope, it was not just a matter of correcting dysfunctions through assistance. The poor are not to be considered a "burden",[1] but a resource, even from the purely economic point of view. It is nevertheless erroneous to hold that the market economy has an inbuilt need for a quota of poverty and underdevelopment in order to function at its best. It is in the interests of the market to promote emancipation, but in order to do so effectively, it cannot rely only on itself, because it is not able to produce by itself something that lies outside its competence. It must draw its moral energies from other subjects that are capable of generating them.

Economic activity cannot solve all social problems through the simple application of *commercial logic*. This needs to be *directed towards the pursuit of the common good*, for which the political community in particular must also take responsibility. Therefore, it must be borne in mind that grave imbalances are produced when economic action, conceived merely as an engine for wealth creation, is detached from political action, conceived as a means for pursuing justice through redistribution.

The Church has always held that economic action is not to be regarded as something opposed to society. In and of itself, the market is not, and must not become, the place where the strong subdue the weak. Society does not have to protect itself from the market, as if the development of the latter were *ipso facto* to entail the death of authentically human relations. Admittedly, the market can be a negative force, not because it is so by nature, but because a certain ideology can make it so. It must be remembered that the market does not exist in the pure state. It is shaped by the cultural configurations which define it and give it direction. 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.

The Church's social doctrine holds that authentically human social relationships of friendship, solidarity and reciprocity can also be conducted within economic activity, and not only outside it or "after" it. The economic sphere is neither ethically neutral, nor inherently inhuman and opposed to society. It is part and parcel of human activity and precisely because it is human, it must be structured and governed in an ethical manner.

The great challenge before us, accentuated by the problems of development in this global era and made even more urgent by the economic and financial crisis, is to demonstrate, in thinking and behaviour, not only that traditional principles of social ethics like transparency, honesty and responsibility cannot be ignored or attenuated, but also that in *commercial relationships* the *principle of gratuitousness* and the logic of gift as an expression of fraternity can and must *find their place within normal economic activity*. This is a human demand at the present time, but it is also demanded by economic logic. It is a demand both of charity and of truth.

The Church's social doctrine has always maintained that *justice must be applied to every phase of economic activity*, because this is always concerned with man and his needs. Locating resources, financing, production, consumption and all the other phases in the economic cycle inevitably have moral implications. *Thus every economic decision has a moral consequence*. The social sciences and the direction taken by the contemporary economy point to the same conclusion. Perhaps at one time it was conceivable that first the creation of wealth could be entrusted to the economy, and then the task of distributing it could be assigned to politics. Today that would be more difficult, given that economic activity is no longer circumscribed within territorial limits, while the authority of governments continues to be principally local. Hence the canons of justice must be respected from the outset, as the economic process unfolds, and not just afterwards or incidentally. Space also needs to be created within the market for economic activity carried out by subjects who freely choose to act according to principles other than those of pure profit, without sacrificing the production of economic value in the process. The many economic entities that draw their origin from religious and lay initiatives demonstrate that this is concretely possible.

In the global era, the economy is influenced by competitive models tied to cultures that differ greatly among themselves. The different forms of economic enterprise to which they give rise find their main point of encounter in commutative justice. *Economic life* undoubtedly requires *contracts*, in order to regulate relations of exchange between goods of equivalent value. But it also needs *just laws* and *forms of redistribution* governed by politics, and what is more, it needs works redolent of the *spirit of gift*. The economy in the global era seems to privilege the former logic, that of contractual exchange, but directly or indirectly it also demonstrates its need for the other two: political logic, and the logic of the unconditional gift.

NOTES

1. John Paul II, *Centessimus Annus*, 28.

EVANGELII GAUDIUM

POPE FRANCIS

29 November 2013

¶ No to an economy of exclusion

In our time humanity is experiencing a turning-point in its history, as we can see from the advances being made in so many fields. We can only praise the steps being taken to improve people's welfare in areas such as health care, education and communications. At the same time we have to remember that the majority of our contemporaries are barely living from day to day, with dire consequences. A number of diseases are spreading. The hearts of many people are gripped by fear and desperation, even in the so-called rich countries. The joy of living frequently fades, lack of respect for others and violence are on the rise, and inequality is increasingly evident. It is a struggle to live and, often, to live with precious little dignity. This epochal change has been set in motion by the enormous qualitative, quantitative, rapid and cumulative advances occurring in the sciences and in technology, and by their instant application in different areas of nature and of life. We are in an age of knowledge and information, which has led to new and often anonymous kinds of power.

Just as the commandment "Thou shalt not kill" sets a clear limit in order to safeguard the value of human life, today we also have to say "thou shalt not" to an economy of exclusion and inequality. Such an economy kills. How can it be that it is not a news item when an elderly homeless person dies of exposure, but it is news when the stock market loses two points? This is a case of exclusion. Can we continue to stand by when food is thrown away while people are starving? This is a case of inequality. Today everything comes under the laws of competition and the survival of the fittest, where the powerful feed upon the powerless. As a consequence, masses of people find themselves excluded and marginalized: without work, without possibilities, without any means of escape.

Human beings are themselves considered consumer goods to be used and then discarded. We have created a "throw away" culture which is now spreading. It is no longer simply about exploitation and oppression, but something new. Exclusion ultimately has to do with what it means to be a part of the society in which we live; those excluded are no longer society's underside or its fringes or its disenfranchised – they are no longer even a part of it. The excluded are not the "exploited" but the outcast, the "leftovers".

In this context, some people continue to defend trickle-down theories which assume that economic growth, encouraged by a free market, will inevitably succeed in bringing about greater justice and inclusiveness in the world. This opinion, which has never been confirmed by the facts, expresses a crude and naïve trust in the goodness of those wielding economic power and in the sacralized workings of the prevailing economic system. Meanwhile, the excluded are still waiting. To sustain a lifestyle which excludes others, or to sustain enthusiasm for that selfish ideal, a globalization of indifference has developed. Almost without being aware of it, we end up being incapable of feeling compassion at the outcry of the poor, weeping for other people's pain, and feeling a need to help them, as though all this were someone else's responsibility and not our own. The culture of prosperity deadens us; we are thrilled if the market offers us something new to purchase. In the meantime all those lives stunted for lack of opportunity seem a mere spectacle; they fail to move us.

¶ No to the new idolatry of money

One cause of this situation is found in our relationship with money, since we calmly accept its dominion over ourselves and our societies. The current financial crisis can make us overlook the fact that it originated in a profound human crisis: the denial of the primacy of the human person! We have created new idols. The worship of the ancient golden calf (cf. *Ex* 32:1-35) has returned in a new and ruthless guise in the idolatry of money and the dictatorship of an impersonal economy lacking a truly human purpose. The worldwide crisis affecting finance and the economy lays bare their imbalances and, above all, their lack of real concern for human beings; man is reduced to one of his needs alone: consumption.

While the earnings of a minority are growing exponentially, so too is the gap separating the majority from the prosperity enjoyed by those happy few. This imbalance is the result of ideologies which defend the absolute autonomy of the marketplace and financial speculation. Consequently, they reject the right of states, charged with vigilance for the common good, to exercise any form of control. A new tyranny is thus born, invisible and often virtual, which unilaterally and relentlessly imposes its own laws and rules. Debt and the accumulation of interest also make it difficult for countries to realize the potential of their own economies and keep citizens from enjoying their real purchasing power. To all this we can add widespread corruption and self-serving tax evasion, which have taken on worldwide dimensions. The thirst for power and possessions knows no limits. In this system, which tends to devour everything which stands in the way of increased profits, whatever is fragile, like the environment, is defenceless before the interests of a deified market, which become the only rule.

❡ No to a financial system which rules rather than serves

Behind this attitude lurks a rejection of ethics and a rejection of God. Ethics has come to be viewed with a certain scornful derision. It is seen as counterproductive, too human, because it makes money and power relative. It is felt to be a threat, since it condemns the manipulation and debasement of the person. In effect, ethics leads to a God who calls for a committed response which is outside the categories of the marketplace. When these latter are absolutized, God can only be seen as uncontrollable, unmanageable, even dangerous, since he calls human beings to their full realization and to freedom from all forms of enslavement. Ethics – a non-ideological ethics – would make it possible to bring about balance and a more humane social order. With this in mind, I encourage financial experts and political leaders to ponder the words of one of the sages of antiquity: "Not to share one's wealth with the poor is to steal from them and to take away their livelihood. It is not our own goods which we hold, but theirs".[1]

58. A financial reform open to such ethical considerations would require a vigorous change of approach on the part of political leaders. I urge them to face this challenge with determination and an eye to the future, while not ignoring, of course, the specifics of each case. Money must serve, not rule! The Pope loves everyone, rich and poor alike, but he is obliged in the name of Christ to remind all that the rich must help, respect and promote the poor. I exhort you to generous solidarity and to the return of economics and finance to an ethical approach which favours human beings.

❡ No to the inequality which spawns violence

Today in many places we hear a call for greater security. But until exclusion and inequality in society and between peoples are reversed, it will be impossible to eliminate violence. The poor and the poorer peoples are accused of violence, yet without equal opportunities the different forms of aggression and conflict will find a fertile terrain for growth and eventually explode. When a society – whether local, national or global – is willing to leave a part of itself on the fringes, no political programmes or resources spent on law enforcement or surveillance systems can indefinitely guarantee tranquility. This is not the case simply because inequality provokes a violent reaction from those excluded from the system, but because the socioeconomic system is unjust at its root. Just as goodness tends to spread, the toleration of evil, which is injustice, tends to expand its baneful influence and quietly to undermine any political and social system, no matter how solid it may appear. If every action has its consequences, an evil embedded in the structures of a society has a constant potential for disintegration and death. It is evil crystallized in unjust social structures, which cannot be the basis of hope for a better future. We are far from the so-called "end of history", since the conditions for a sustainable and peaceful development have not yet been adequately articulated and realized.

60. Today's economic mechanisms promote inordinate consumption, yet it is evident that unbridled consumerism combined with inequality proves doubly damaging to the social fabric. Inequality eventually engenders a violence which recourse to arms cannot and never will be able to resolve. It serves only to offer false hopes to those clamouring for heightened security, even though nowadays we know that weapons and violence, rather than providing solutions, create new and more serious conflicts. Some simply content themselves with blaming the poor and the poorer countries themselves for their troubles; indulging in unwarranted generalizations, they claim that the solution is an "education" that would tranquilize them, making them tame and harmless. All this becomes even more exasperating for the marginalized in the light of the widespread and deeply rooted corruption found in many countries – in their governments, businesses and institutions – whatever the political ideology of their leaders.

NOTES

1. St John Chrysostom, *De Lazaro Concio*, II, 6: p. 48, 992D.

ADDRESS TO THE MEMBERS OF THE CENTESIMUS ANNUS—PRO PONTIFICE FOUNDATION

POPE BENEDICT XVI

Clementine Hall, 13 June 2009

Thank you for your visit which fits into the context of your annual meeting. I greet you all with affection and am grateful to you for all that you do, with proven generosity, at the service of the Church. I greet and thank your President, Count Lorenzo Rossi di Montelera, who has expressed your sentiments with fine sensitivity, giving an overview of the Foundation's work. I also thank those who, in various languages, have wished to express your common devotion. Our meeting today acquires special meaning and value in the light of the situation that humanity as a whole is experiencing at this time.

Indeed, the financial and economic crisis which has hit the industrialized, the emerging and the developing countries, shows clearly that certain economic and financial paradigms which prevailed in recent years must be rethought. Therefore, at the international congress which took place yesterday your Foundation did well to address the topic of the search for, and identification of, the values and rules which the economic world should abide by in order to evolve a new model of development that is more attentive to the requirements of solidarity and more respectful of human dignity.

I am pleased to learn that you examined in particular the interdependence between institutions, society and the market, in accordance with my venerable Predecessor John Paul II's Encyclical, *Centesimus annus*. The Encyclical states that the market economy, understood as: "an economic system which recognizes the fundamental and positive role of business, the market, private property and the resulting responsibility for the means of production, as well as free human creativity in the economic sector" (n. 42), may be recognized as a path to economic and civil progress only if it is oriented to the common good (cf. n. 43). However, this vision must also be accompanied by another reflection which says that freedom in the economic sector must be circumscribed "by a strong juridical framework which places it at the service of human freedom in its totality," a responsible freedom, "the core of which is ethical and religious" (n. 42). The above-mentioned Encyclical appropriately states: "just as the person fully realizes himself in the free gift of self, so too ownership morally justifies itself in the creation, at the proper time and in the proper way, of opportunities for work and human growth for all" (n. 43).

I hope that by drawing inspiration from the eternal principles of the Gospel it will be possible, with the research inherent in your work, to elaborate a vision of the modern economy that is respectful of the needs and rights of the weak. My Encyclical dedicated to the vast topic of the economy and work is, as you know, due to be published shortly. It will highlight what for Christians are the objectives to pursue and the values to promote and to defend tirelessly, if we are to achieve a truly free and supportive human coexistence. I likewise note with pleasure all that you do for the Pontifical Institute for Arab and Islamic Studies (PISAI), to whose goals you and I attribute great value for an increasingly fruitful interreligious dialogue.

Dear friends, thank you once again for coming! I assure each one of you of my remembrance in prayer, while I warmly bless you all.

ADDRESS TO THE SIXTEENTH PLENARY SESSION OF THE PONTIFICAL ACADEMY OF SOCIAL SCIENCES

POPE BENEDICT XVI

Consistory Hall, 30 April 2010

I am pleased to greet you at the beginning of your Sixteenth Plenary Session, which is devoted to an analysis of the global economic crisis in the light of the ethical principles enshrined in the Church's social doctrine. I thank your President, Professor Mary Ann Glendon, for her gracious words of greeting and I offer you my prayerful good wishes for the fruitfulness of your deliberations.

The worldwide financial breakdown has, as we know, demonstrated the fragility of the present economic system and the institutions linked to it. It has also shown the error of the assumption that the market is capable of regulating itself, apart from public intervention and the support of internalized moral standards. This assumption is based on an impoverished notion of economic life as a sort of self-calibrating mechanism driven by self-interest and profit-seeking. As such, it overlooks the essentially ethical nature of economics as an activity *of* and *for* human beings. Rather than a spiral of production and consumption in view of narrowly-defined human needs, economic life should properly be seen as an exercise of human responsibility, intrinsically oriented towards the promotion of the dignity of the person, the pursuit of the common good and the integral development – political, cultural and spiritual – of individuals, families and societies. An appreciation of this fuller human dimension calls, in turn, for precisely the kind of cross-disciplinary research and reflection which the present session of the Academy has now undertaken.

In my Encyclical *Caritas in Veritate*, I observed that "the current crisis obliges us to re-plan our journey, to set ourselves new rules and to discover new forms of commitment" (No. 21). Re-planning the journey, of course, also means looking to comprehensive and objective standards against which to judge the structures, institutions and concrete decisions which guide and direct economic life. The Church, based on her faith in God the Creator, affirms the existence of a universal natural law which is the ultimate source of these criteria (cf. *ibid.*, 59). Yet she is likewise convinced that the principles of this ethical order, inscribed in creation itself, are accessible to human reason and, as such, must be adopted as the basis for practical choices. As part of the great heritage of human wisdom, the natural moral law, which the Church has appropriated, purified and developed in the light of Christian revelation, serves as a beacon guiding the efforts of individuals and communities to pursue good and to avoid evil, while directing their commitment to building an authentically just and humane society.

Among the indispensable principles shaping such an integral ethical approach to economic life must be the promotion of the common good, grounded in respect for the dignity of the human person and acknowledged as the primary goal of production and trade systems, political institutions and social welfare. In our day, concern for the common good has taken on a more markedly global dimension. It has also become increasingly evident that the common good embraces responsibility towards future generations; intergenerational solidarity must henceforth be recognized as a basic ethical criterion for judging any social system. These realities point to the urgency of strengthening the governance procedures of the global economy, albeit with due respect for the principle of subsidiarity. In the end, however, all economic decisions and policies must be directed towards "charity in truth", inasmuch as truth preserves and channels the liberating power of charity amid ever-contingent human events and structures. For "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" (*Caritas in Veritate*, 5).

With these considerations, dear friends, I once more express my confidence that this Plenary Session will contribute to a more profound discernment of the serious social and economic challenges facing our world, and help point the way forward to meet those challenges in a spirit of wisdom, justice and authentic humanity. I assure you once more of my prayers for your important work, and upon you and your loved ones I cordially invoke God's blessings of joy and peace.

INTERVIEW WITH THE JOURNALISTS DURING THE FLIGHT TO MADRID ON THE OCCASION OF THE 26TH WORLD YOUTH DAY

POPE BENEDICT XVI

Papal Flight, 18 August 2011

Fr Federico Lombardi, SJ:

Your Holiness, times are changing. Europe and the Western world in general are going through a profound economic crisis which is also showing dimensions of serious social and moral hardship and great uncertainty for the future which is becoming particularly acute for young people. In the past few days we have seen, for example, what happened in Great Britain when rebellion and aggressiveness were unleashed. At the same time there are signs of generous and enthusiastic commitment, of voluntary service and of solidarity, of young believers and non-believers alike. In Madrid we shall meet a large number of marvellous young people. What message of hope can the Church provide to encourage youth throughout the world, especially those who feel discouraged today and are tempted to rebel?

The Holy Father:

It is this. In the current economic crisis what formerly appeared in the previous great crisis has been confirmed: namely, that the ethical dimension is not alien to economic problems but an internal and fundamental dimension of them. The economy does not function with a self-regulation of the market alone, but it needs an ethical reason if it is to function for man. And once again Pope John II's words in his first social Encyclical become apparent: man must be the centre of the economy and the economy cannot be measured according to the maxim of profit but rather according to the common good of all, that it implies responsibility for others and only really functions well if it functions humanly, with respect for others. And with the different dimensions: responsibility for one's own nation and not only for oneself; responsibility for the world — even a nation is not isolated, even Europe is not isolated but is responsible for the whole of humanity and must always think about economic problems in this key of responsibility for the other parts of the world too, for all who suffer, who thirst and hunger, who have no future. And so — a third dimension of this responsibility — is responsibility for the future.

We know we must protect our planet but, all things considered, we must protect a functional service of employment for everyone and realize that tomorrow is also today. If today's young people have no prospects in life then our own life today is misguided and "wrong". Therefore the Church, with her social doctrine, with her doctrine on responsibility to God, proposes the readiness to give up the maxim of profit and to see things in the humanistic and religious dimension: in other words existing for each other. Thus new ways can also be found. The throngs of volunteers who are working in various parts of the world, not for themselves but for others, and who thereby find the meaning of life, show that it is possible to do this and that an education in these great goals, such as the Church tries to provide, is fundamental for our future.

INTERVENTION BY THE HOLY SEE AT THE 63RD SESSION OF THE UN GENERAL ASSEMBLY ON THE GLOBAL FINANCIAL CRISIS

ADDRESS OF H.E. MSGR CELESTINO MIGLIORE

New York, 30 October 2008

Many economists and analysts are agreed that the crisis can be attributed to a lack of a complete and effective regulatory system, but even more to a widespread disregard for regulatory and supervisory structures, to say nothing of the rules of accountability and transparency.

My delegation endorses this view and would go one step further: the real crisis does not appear to be merely financial, economic and technical. Rather, it extends to the broader realm of ethical codes and moral conduct. Unbridled profiteering and the unscrupulous pursuit of gain at any cost have made people forget basic rules of business ethics.

Our reaction should not be limited to deploring the crisis and offering formal expressions of sympathy to the poorer countries and social strata which have been affected. We need to come up with the ways and means to avoid similar crises in the future.

In some cases, governments and institutions which rigorously implemented rules at the lower customer level were lax in maintaining that same rigor at the higher level. The same could also be said with regard to the economic systems of poorer countries. International financial institutions which strictly implemented conditionalities and oversight in developing countries neglected to do so when overseeing developed economies. Now that the latter have collapsed, the former also have to bear the consequences.

Government is the exercise of the virtue of prudence in the enactment of legislative and executive measures capable of directing social activity towards the common good. The principle of subsidiarity requires that governments and large international agencies ensure solidarity on the national and global levels and between generations.

A second observation pertains to the responsibility of those who work in the financial sector. Lending is a necessary social activity. Nonetheless, financial institutions and agents are responsible for ensuring that lending fulfils its proper function in society, connecting savings to production. If lending is seen merely in terms of trading off financial resources without regard for their reasonable use, it fails to be a service to society. When attempts are made to conceal the real risk that loans will not be repaid, savers are cheated and lenders become actual accomplices in theft.

It must not be forgotten that at the edges of the financial system there are retired persons, small family businesses, cottage industries and countless employees for whom savings are an essential means of support. Financial activity needs to be sufficiently transparent so that individual savers, especially the poor and those least protected, understand what will become of their savings. This calls not only for effective measures of oversight by governments, but also for a high standard of ethical conduct on the part of financial leaders themselves.

A third, and perhaps even more basic, observation has to do with the general public and its choice of values and lifestyles. A lifestyle, and even more an economic model, solely based on increased and uncontrolled consumption and not on savings and the creation of productive capital, is economically unsustainable. It also becomes unsustainable from the standpoint of concern for the environment and, above all, of human dignity itself, since the irresponsible consumer renounces his own dignity as a rational creature and also offends the dignity of others.

Looking towards the future, there is a need to restore credibility and authenticity to lending, which always needs to be a part of the product chain of goods and services, and not an independent activity.

Above all, however, there is a need to invest in people. Once the inevitable financial salvage operations are over, governments and the international community should invest their money in aid to the poorest populations.

The relatively recent and positive experience of microcredit shows that, paradoxically, those who, from the standpoint of cold hard financial calculation, seem least suitable to receive credit, are by and large the most serious and reliable borrowers.

The history of developed countries also demonstrates that grants for health, education, housing and other basic services benefiting the weakest socio-economic levels of society, families and small communities, ultimately prove to be the most profitable investments, since they alone ensure the harmonious functioning of society as a whole.

INTERVENTION BY THE HOLY SEE AT THE DOHA CONFERENCE (QATAR)

ADDRESS OF H.E. MSGR CELESTINO MIGLIORE

Doha, 1 December 2008

Financing for development

Six years ago, world leaders gathered in Monterrey, Mexico, to begin a new process for addressing together the needs of the poorest among us. At that time, the world was reeling from the terrorist attacks of 11 September 2001, and the subsequent economic decline, but despite these hurdles, it still came together to craft the Monterrey Consensus which created a new vision for a shared future.

Today, we meet in Doha, Qatar, to assess the lessons learned and to create ways and means for realizing the vision of Monterrey. However, again we come with a cloud hanging over our heads: the anxiety over the economic and political consequences of an unprecedented financial crisis and the persistent devastating presence of terrorism, as evidenced by the tragic events in Mumbai, India.

This crisis presents an enormous challenge in finding ways to address the concerns of those most in need. At its root, the financial crisis is not a failure of human ingenuity but rather of moral conduct. Unbridled human ingenuity crafted the systems and means for providing highly leveraged and unsustainable credit limits which allowed people and companies alike to pursue material excess at the expense of long-term sustainability. Unfortunately, we are now seeing the effects of such short-term greed and lack of prudence, and as a result those who recently were able to rise out of extreme poverty are now likely to fall back. We often speak of sustainable development as an overarching principle for developing countries.

Sustainable development meets the needs of the present without compromising the ability of future generations to meet their needs. Likewise, sustainable financing should meet the present capital needs for development, while ensuring the long-term preservation and increase of resources. It is time for developed and developing countries alike to reaffirm the principle of sustainable financial development, apply it to financial markets and thus create truly sustainable capital management. Such is the great challenge of this Conference: nothing less than to ensure, in a sustainable way, the financing for development.

Global development is, at its heart, a question not only of technical logistics but more fundamentally of morality. Social and economic development must be measured and implemented with the human person at the center of all decisions. The last six years have seen an increase in aid flows and encouraging developments in a number of indicators and statistics. However, questions remain: how many people do not have access to food, how many live with fear of war and oppression, how many do not have access to even basic healthcare and how many lack decent employment to provide a living wage for themselves and their families? Unfortunately, the answer remains: too many.

These are the questions and concerns which must be at the heart of our strategies in order to ensure that development is measured not only by capital gain but more importantly by lives sustained.

Since Monterrey, we have again seen the importance for each and every country to uphold good governance in order to provide the means for personal as well as global development. Governmental leadership which provides for effective financial systems, just taxation, responsible spending and good stewardship of the environment, sets the foundation for countries upon which to build. Transparency, the rule of law and good governance guarantee the stability and financial certainty needed in order to provide job creation, tax revenues and long term growth. Further, good governance, respect for human rights and social stability assure the means for civil society actors, including faith-based organizations, to offer the life saving and life affirming services which are oftentimes beyond the capacities of national and local governments.

National governments need the cooperation of the international community in order to accelerate economic and human development. Since Monterey we have seen renewed commitment towards the target of 0.7% Gross National Income in Official Development Assistance (oda).

However, we still remain far behind this goal and have recently seen a slight decline in oda. Too often developed countries state that development assistance is too cumbersome, yet such an explanation lacks sincerity, especially when we see the increase of military spending at levels many times greater than development assistance. Similarly, the recent financial crisis demonstrates that when political will is combined with concern for the common good we are able to generate, within months, substantial funds for financial markets which are far greater than the total amount of oda expended since Monterrey. Surely, it goes without saying that the same political will and concern for the common good of the financial systems applies to the poorest and most vulnerable.

The international community must also give greater respect for the voices of those countries and individuals most in need of financial assistance. The Bretton Woods institutions need to be refocused and the so called G-8 and G-20 countries must ensure that the voices of those who are in such need of development assistance are heard and respected. A purely top down approach to development will remain insufficient unless greater concern is given to those whose lives and countries are at stake.

The United Nations continues to serve as a vital forum for bringing all voices together in order to foster greater global solidarity. Likewise, renewed attention must be given to ensuring more just and equitable trade systems. These days we have heard many calls for a greater commitment to implementing the Doha-Round trade talks. However, these talks will continue to languish unless countries express the necessary political fortitude to promote fair trade and make the inevitable required sacrifices. Further, trade-distorting subsidies, financial speculation, increased energy prices and decreased investment in agriculture have recently given rise to lack of access to the very thing which is necessary for life namely food. This economic volatility, which strikes at the heart of human existence, gives greater urgency to finding a common commitment to addressing global trade and development.

Uncertainty and anxiety seem to prevail at this particular point in time. However, the virtues and principles which have led the global community out of so many crises remain; that of solidarity with our global community, just and equitable sharing in resources and opportunity, prudent use of the environment, restraint from seeking short-term financial and social gain at the expense of sustainable development, and finally, the political courage which is necessary to build a world in which human life is placed at the center of all social and activities. By embracing these fundamental principles we will help to create a world in which social, economic and spiritual growth is accessible to all.

INTERVENTION BY THE HOLY SEE AT THE SPECIAL SESSION OF THE HUMAN RIGHTS COUNCIL ON THE WORLD FINANCIAL CRISIS

ADDRESS OF H.E. MSGR SILVANO M. TOMASI

Geneva, 20 February 2009

As we are daily reminded by the media, the world financial crisis has created a global recession causing dramatic social consequences, including the loss of millions of jobs and the serious risk that, for many of the developing countries, the Millennium Development Goals (MDGs) may not be reached. The human rights of countless persons are compromised, including the right to food, water, health and decent work. Above all, when large segments of a national population see their social and economic rights frustrated, the loss of hope endangers peace. The international community has a legitimate responsibility to ask why such a situation developed; whose responsibility it is; and how a concerted solution can lead us out of the crisis and facilitate the restoration of rights. The crisis was caused, in part, by problematic behaviour of some actors in the financial and economic system, including bank administrators and those who should have been more diligent in monitoring and accountability systems; thus they bear much responsibility for the current problems. The causes of the crisis, however, are deeper.

Reflecting, at that time, on the 1929 crisis Pius XI observed that: "… it is obvious that not only is wealth concentrated in our times but an immense power and despotic economic dictatorship is consolidated in the hands of a few, who often are not owners but only the trustees and managing directors of invested funds which they administer according to their own arbitrary will and pleasure" (QA, 105). He also noted that free competition had destroyed itself by relying on profit as the only criterion. There are economic, juridical and cultural dimensions of the present crisis. To engage in financial activity cannot be reduced to making easy profits, but also must include the promotion of the common good among those who lend, those who borrow, and those who work. The lack of an ethical base has brought the crisis to low, middle and high income countries alike. The Delegation of the Holy See, Mr. President, calls for renewed attention to the need for an ethical approach to the creation of positive partnerships between markets, civil society and States.

The negative consequences, however, exert a more dramatic impact on the developing world and on the most vulnerable groups in all societies. In a recent document, the World Bank estimates that, in 2009, the current global economic crisis could push an additional 53 million people below the threshold of $2 a day. This figure is in addition to the 130 million people pushed into poverty in 2008 by the increase in food and energy prices. Such trends seriously threaten the achievement of the fight against poverty in the Millennium Development Goals by 2015. Evidence indicates that children, in particular, will suffer the most from economic hardship, and a strong increase in the infant mortality rate in poor countries is forecasted for 2009.

It is well known that low-income countries are heavily dependent upon two financing flows: foreign aid and migrant remittances. Both flows are expected to decline significantly over the next months, due to the worsening of the economic crisis. Despite the official reaffirmation of commitment by donors to increase Official Development Assistance (ODA) in accord with the Gleneagles agreement, currently most donors are not on track to meet their target for significant scale-up of ODA by 2010. Moreover, the most recent figures reveal a slowing down of aid flows. This results in worry that a possible direct effect of the global economic crisis will be a major reduction of aid to the poor countries. On the other hand, remittances from migrant workers already have been reduced significantly. This threatens the economic survival of entire families who derive a consistent share of their income from the transfer of funds by relatives working overseas.

The Delegation of the Holy See, Mr. President, would like to focus on a specific case in this crisis: its impact on the human rights of children, which exemplifies, as well, what is symptomatic of the destructive impact on all other social and economic rights. At present some important rights of poor people are heavily dependent on official aid flows and on workers' remittances. These include the right to health, education, and food. In several poor countries, in fact, educational, health and nutritional programmes are implemented with the help of aid flows from official donors. Should the economic crisis reduce this assistance, the successful completion of these programs could be threatened. By the same token, in many poor regions, entire families can afford to have their children educated and decently nourished due to remittances received from migrants. If the reduction of both aid and remittances continue, it will deprive children of the right to be educated creating a double negative consequence. Not only will we prevent children from the full exercise of their talent that, in turn, could be put to use for the common good, but also the preconditions will be established for long-range economic hardship. Lower educational investment today, in fact, will be translated into lower future growth. At the same time, poor nutrition among children significantly worsens life expectancy by increasing both child and adult mortality rates. The negative economic consequences of this go beyond the personal dimension and affect entire societies.

Mr. President, let me mention another consequence of the global economic crisis that could be particularly relevant for the mandate of the United Nations. All too often, periods of severe economic hardship have been characterized by the rise in power of governments with dubious commitments to democracy. The Holy See prays that such consequences will be avoided in the present crisis, since they would result in a serious threat for the diffusion of basic human rights for which this institution has so tenaciously struggled.

The last fifty years have witnessed some great achievements in poverty reduction. Mr. President, these achievements are at risk, and a coherent approach is required to preserve them through a renewed sense of solidarity, especially for the segments of population and for the countries more affected by the crisis. Old and recent mistakes will be repeated, however, if concerted international action is not undertaken to promote and protect all human rights and if direct financial and economic activities are not placed on an ethical road that can prioritize persons, their productivity and their rights over the greed that can result from a fixation on profit alone.

INTERVENTION OF THE HOLY SEE AT THE HIGH LEVEL SEGMENT OF THE 13TH ORDINARY SESSION OF THE HRC ON THE WORLD ECONOMIC AND FINANCIAL CRISIS

ADDRESS OF H.E. MSGR SILVANO M. TOMASI

Geneva, 3 March 2010

The Delegation of the Holy See wants to restate its conviction that the perspective of human rights provides a positive contribution for a solution to the current financial crisis. Even though some signs of recovery seem visible, the crisis continues to aggravate the conditions of millions of people in their access to the basic necessities of life and has adversely compromised the retirement plans of many. This situation, therefore, calls for new regulations and a sound global system of governance that ensures a sustainable and comprehensive path to development for all. In the establishment of new regulations and reliable governance there exists a unique opportunity to address the root causes of the crisis and to affirm an integrated approach to the implementation of all economic, social, civil and political human rights as outlined in the Universal Declaration of Human Rights.

United Nations reports give plenty of evidence regarding the many negative consequences of the financial crisis: the scandal of hunger, the growing inequality worldwide, millions of unemployed people and millions of others reduced to extreme poverty, institutional failures, lack of social protection for countless vulnerable persons. These imbalances, the Holy Father reminds us in the recent encyclical *Caritas in veritate* "are produced when economic action, conceived merely as an engine for wealth creation, is detached from political action, conceived as a means for pursuing justice through redistribution."[1] Equity and justice are essential criteria in the management of the world economy.

The enjoyment of human rights becomes possible when States translate principles into law and make change on the ground a reality. While the State is the first actor in the implementation of human rights, it cannot fail to collaborate with all other players in its own civil society and with the international community, interconnected and interdependent as we are in today's globalized world. In fact, the common goal is the protection and respect of human dignity that binds together the entire human family, a unity rooted on the four basic principles of the centrality of the human person, solidarity, subsidiarity and the common good. In this context, the review of the Human Rights Council should aim also at making change on the ground a reality and the concrete implementation of human rights, its priority.

An important message conveyed by Pope Benedict XVI in *Caritas in veritate* in this moment of economic crisis is the invitation to overcome the obsolete dichotomy between the economic, social and ecological spheres. Markets and freedom are important requirements in building a healthy society, but the context within which they operate is global and must include the universal principles of honesty, justice, solidarity and in addition the principles of 'reciprocity and gift'.[2] The focus of concern in the reform of the financial system, and the economic models that are operative in government programs and corporate policies, should shift from goods and services to the persons who are recipients of these services; in this way, they have access to the resources to improve their position in life and thus place their talents at the service of their local community and the universal common good. The social doctrine of the Church has always pursued such a goal with special care for the more vulnerable members of society. In fact, by giving priority to human beings and the created order that supports them on their earthly journey, we can modify the rules that govern the financial system to serve concrete change, to move away from old habits of greed that led to the present crisis, and to promote effective integral development and the implementation of human rights since "the primary capital to be safeguarded and valued is the human person in his or her integrity."[3]

NOTES

1. Benedict XVI, Caritas in Veritate, 36.
2. *Ibid.* "The great challenge before us, accentuated by the problems of development in this global era and made even more urgent by the economic and financial crisis, is to demonstrate, in thinking and behaviour, not only that traditional principles of social ethics like transparency, honesty and responsibility cannot be ignored or attenuated, but also that in *commercial relationships* the *principle of gratuitousness* and the logic of gift as an expression of fraternity can and must *find their place within normal economic activity.* This is a human demand at the present time, but it is also demanded by economic logic. It is a demand both of charity and of truth."
3. *Ibid* at 25.

INTERVENTION BY THE HOLY SEE AT THE 64TH SESSION OF THE UN GENERAL ASSEMBLY ON FINANCING OF DEVELOPMENT

ADDRESS OF H.E. MSGR CELESTINO MIGLIORE

New York, 24 March 2010

The devastating impact of the recent financial crisis on the world's most vulnerable populations has been highlighted in almost all the interventions made so far in this General Assembly because it really is a concern shared by governments and citizens all over the world. Indeed, the dark shadow of this crisis is likely to frustrate efforts made so far to help reduce poverty and only add to the skyrocketing numbers living in extreme poverty.

At the same time, the current economic crisis has also given rise to unprecedented international political cooperation, evident in the three successive high-level G-20 meetings in Washington, London, and Pittsburgh during 2009. These meetings were able to reach agreement on emergency measures to reignite the world economy, including fiscal and monetary stimulus packages that have prevented a global catastrophe. Overall, the G-20 deliberations have received the moral support of most UN members, even recognizing the low ratio of member participation in them.

Nevertheless, the stabilization of some economies, or the recovery of others, does not mean that the crisis is over. Moreover, there is a general perception about the lack of sound political and economic foundations needed to ensure longer-term stability and sustainability of the global economy. Indeed, the whole world economy, where countries are highly interdependent, will never be able to function smoothly if the conditions that generated the crisis persist, especially when fundamental inequalities in income and wealth among individuals and between nations continue.

Against this background, my delegation underscores the view that we cannot wait for a definitive and permanent recovery of the global economy to take action. A significant reason is that the re-activation of the economies of the world's poorest people will surely help guarantee a universal and sustainable recovery. But the most important reason is the moral imperative: not to leave a whole generation, nearly a fifth of the world's population, in extreme poverty.

There is now an urgent need to reform, strengthen and modernize the whole funding system for developing countries as well as UN programs, including the specialized agencies and regional organizations, making them more efficient, transparent, and well coordinated, both internationally and locally. In the same vein, the crisis has highlighted the urgent need to proceed with the reform of the International Monetary Fund (IMF) and World Bank, whose structures and procedures must reflect the realities of today's world and no longer those of the post World War II period.

As pointed out in the Doha Declaration, of December 2008, a reformed IMF should be able to accomplish fully its original mandate of stabilizing currency fluctuations and ought to be provided with mechanisms for preventing financial crises. The functions of the Financial Stability Forum (FSF) would acquire greater legitimacy if they were developed in close collaboration with the Fund and other relevant UN bodies, such as UNCTAD. The international community, through its appropriate bodies, such as the IMF, the FSF and others, should be able to make proposals to improve banking regulations. It should be able to identify and define the capital requirements for banks, liquidity requirements, transparency measures, and accountability standards for the issuance and trading of securities. Equally important are the regulatory norms for the para-banking activities and control of rating companies. We would do well not to wait for consensus on all these issues but move ahead in areas where there is already broad consensus, such as uniform international accounting standards.

On the other hand, the international community, through the World Bank and relevant multilateral agencies, should continue to give priority to the fight against poverty, particularly in LDCs. In this context, as part of the emergency measures of developed countries to address the crisis, contributions to the World Bank destined to fight extreme poverty should have highest priority. Although the financial crisis made it necessary to increase aid to middle income countries through the International Bank for Reconstruction and Development (IBRD), the World Bank must continue to give priority to loans under the International Development Association (IDA), which assists low income countries and provides resources for food security.

To this end, we must continue to review the distribution of voting rights in both these financial institutions so that emerging economies and developing countries, including LDCs, are duly represented. Similarly, it may be desirable to introduce, at least for key decisions, 'double majority' approval, so that decisions are made not only according to quotas but also on the basis of a numerical majority of countries.

At the end of World War II, the international community was able to adopt a comprehensive system that would ensure not only peace but also avoid a repetition of global economic disruption. The institutions that emerged from the Bretton Woods Conference in July 1944 had to ensure the launching of a process of equitable economic development for all. The current global crisis offers a similar opportunity requiring a comprehensive approach, based on resources, knowledge transfer and on institutions. To achieve this, all nations, without exception, need to commit themselves to a renewed multilateralism.

At the same time, the effectiveness of measures taken to overcome the current crisis should always be assessed by their ability to solve the primary problem. We should not forget that the same world that could find, within a few weeks, trillions of dollars to rescue banks and financial investment institutions, has not yet managed to find 1% of that amount for the needs of the hungry - starting with the $3 billion needed to provide meals to school children who are hungry or the $5 billion needed to support the emergency food fund of the World Food Program.

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The financial crisis and its many developments have brought to the forefront a sea change most people were unaware of in 2008. The financial economy had from the mid-1980s overtaken the real economy and expanded so much to become pervasive. All kinds of goods and commodities are transformed into financial assets or securities and sold on global exchanges. Especially debts—consumer credit, mortgages, credit cards, etc.—were appealing. Thus, over the last three decades financial assets became increasingly and silently part of our everyday life. So much so, that a total collapse of financial markets would actually be akin to a reboot of our way of life and of most of our institutions.

This working paper addresses this change and gives a well-developed and informed understanding of how we came to this. But most of it is dedicated to another point: which path is open today out of the crisis? What lies beyond the crisis? The return to 'business as usual'? Have we learned nothing?

Financial markets are not evil per se. They do have a social function, but must work for the Common Good if they want to earn to it. What does this concretely mean? Drawing upon Catholic Social Teaching, Paul Dembinski and Simona Beretta reassert forgotten truth and explore new and challenging perspectives.

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