

THE PONTIFICAL  
ACADEMY OF  
SOCIAL SCIENCES

Acta

16

# CRISIS IN A GLOBAL ECONOMY RE-PLANNING THE JOURNEY

*Edited by*

José T. Raga  
Mary Ann Glendon



The Proceedings of the 16th Plenary Session  
of the Pontifical Academy of Social Sciences

30 April-4 May 2010 • Casina Pio IV



VATICAN CITY  
2011

This volume of the Proceedings of the  
Pontifical Academy of Social Sciences is dedicated to

DR. DR. HERBERT BATLINER

In grateful recognition of the wisdom and support  
he has provided as a friend of the Academy  
from the day of its inception

*Tantum apud nos grati animi  
fidelis memoria valet*

(Cic. Pro Marcello, V)

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— Acta 16 —

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VATICAN CITY 2011

The opinions expressed with absolute freedom during the presentation of the papers of this plenary session, although published by the Academy, represent only the points of view of the participants and not those of the Academy.

978-88-86726-27-6

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THE PONTIFICAL ACADEMY OF SOCIAL SCIENCES  
VATICAN CITY



His Holiness Pope Benedict XVI



Participants in the conference hall of the Casina Pio IV



Participants in the conference hall of the Casina Pio IV



The Participants of the 16th Plenary Session

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ADDRESS OF HIS HOLINESS BENEDICT XVI TO THE  
PARTICIPANTS IN THE SIXTEENTH PLENARY SESSION  
OF THE PONTIFICAL ACADEMY OF SOCIAL SCIENCES

CONSISTORY HALL, 30 APRIL 2010

Dear Members of the Academy,

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.

## ADDRESS TO THE HOLY FATHER

MARY ANN GLENDON

Holy Father,

In your encyclical *Caritas in Veritate*, you expressed your hope to stimulate discussion on the role of moral and spiritual values in the current economic crisis, as well as your desire for discussions to lead to new models for a responsible economy. By dedicating our XVIth Plenary Session to the Global Economic Crisis, Your Holiness, your Academy of Social Sciences aims to respond to that invitation.

In the coming days, we will seek first to gain a clear picture of the nature and causes of the current crisis, and to assess its impact on peoples and communities throughout the world, with special attention to those who were least advantaged even before the recent upheavals. Then we will turn our attention to what needs to be done to 're-plan the journey', if economic systems are to serve the common good. We will be exploring the problem of how to foster the conditions of trustworthiness and reciprocal responsibilities that the market requires even to perform its specifically economic functions. We will be asking what moral and juridical resources are needed to assure that the market's creative energies promote the good of all. We will be asking how to keep the human person always at the center of concern.

In pursuing those inquiries, we cannot help but be mindful, Your Holiness, that one factor in the current crisis has been the tendency to remove values and morality from economic discussions. As you have noted, 'The excessive segmentation of knowledge, the rejection of metaphysics by the human sciences, the difficulties encountered by the dialogue between science and theology are damaging not only to the development of knowledge, but also the development of people, because these things make it harder to see the integral good of man in its various dimensions'.

For all these reasons, the current crisis provides us with an occasion for introspection about the state of the social sciences. Regrettably, all too

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many economists, jurists, sociologists, and political scientists have accepted faulty assumptions about human nature and promoted relativistic attitudes toward morality and truth. Such approaches and attitudes have not only impoverished each of our disciplines, but have had serious practical consequences, for they have influenced the mentalities of policy makers, and shaped their approaches to business, governmental, and even philanthropic programs.

We will therefore keep in mind, as we deliberate, your insistence that, ‘moral evaluation and scientific research must go hand in hand, and...charity must animate them in a harmonious interdisciplinary whole’. And we will remember your stirring warning to the members of the Institut de France last fall, when you said, quoting Rabelais, that ‘Science sans conscience est la ruine de l’âme!’

It only remains for me, dear Holy Father, to express our gratitude for the appointment of our new academicians, Professors Russell Hittinger and Janne Matlary, and to ask you to bless this Academy and all those who have generously consented to share their wisdom with us over the next few days. We thank you most sincerely for the gift of this encounter.

## 2010 PRESIDENT'S REPORT

MARY ANN GLENDON

In its Sixteenth Plenary Session, the Pontifical Academy of Social Sciences embraced Pope Benedict XVI's invitation in *Caritas in Veritate* to examine the global economic crisis with special attention to the role of moral and spiritual values. To a greater degree than past Academy meetings, the conference organized by Academician José Raga focused on current events – the ongoing upheavals in the financial sector and their rippling effects throughout the economies of many nations. As it happened, an economic crisis erupted in Greece just before our meeting, which meant that the questions we examined were especially timely.

In an audience for the Academicians and invited speakers on the first day, the Holy Father offered words of appreciation for the Academy's work. He set the tone for our deliberations by emphasizing that the economic crisis has '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'.

The presentations at the Plenary began with analyses of the nature and causes of the current crisis, and its impact on peoples and communities throughout the world, especially those who were least advantaged even before the recent upheavals. The discussion then moved to what needs to be done to 're-plan the journey' if economic systems are to serve the common good.

Four principal themes emerged from the presentations and discussions:

1. Financialization of the economy and human relations. There was general consensus that the current economic crisis had its roots in the financial sector. The fragility of the economic system was partly due to over-reliance on speculative financial activities separated from produc-

- tive activity in the real economy. Some speakers also warned of the danger of the 'financialization' of human relations, even within the family.
2. A second common theme concerned the toll that economic crisis was taking on poor countries, even though its origin was in the wealthy nations. Some speakers noted that if one compares the cost of the financial bailouts to the amounts needed to provide the world's poor with basic nutrition, it is evident that the crisis has distracted greatly from urgent questions of development. Others pointed out that meeting basic needs, especially for children, beginning in the womb, makes a decisive contribution to economic productivity.
  3. There was also broad consensus on the need for improved methods of regulation with careful attention to the proper roles of governmental entities, private actors and international bodies. A highlight of the Plenary was a session featuring three invited experts on banking: Lucas Papademos of the European Central Bank, Mario Draghi, Governor of the Bank of Italy, and Ettore Gotti Tedeschi, President of the Istituto per le Opere di Religione (the 'Vatican Bank'). Joined by Academicians Hans Tietmeyer, former president of the Deutsche Bundesbank, and Luis Ernesto Derbez Bautista, former Minister of Economics in Mexico, this group discussed the need for stronger regulation of international finance, and suggested various concrete measures to assure greater transparency in financial instruments and to avoid the moral hazards arising from bailouts.
  4. Finally, the members welcomed the hopeful note sounded by Ferrari Chairman Luca Cordero di Montezemolo who pointed out that the economic crisis will certainly stimulate the search for much-needed innovations in industry, agriculture and employment to better serve the world's needs for food, renewable energy, and transportation.

In his summation as the Coordinator of the Plenary, Professor Raga called attention to the responsibilities of educators. Given the pervasive emphasis on materialism and utilitarianism, he said, one can hardly be surprised 'that in the current crisis, there has been an abundance of cheating and fraud and excessive regard for the short-term coupled with disdain for that which belongs to the long-term'. Looking to the future, he called for cooperation among 'open-minded people, with the capacity to integrate into working teams and with ability for reflection; people who are convinced that the world is so complex that only with the cooperation of others will we achieve the fruit of our labors; moreover, that only with a joint vision will it be possible to find a solution'.

\* \* \*

*Future Meetings*

2011. In response to my June 9, 2009, letter to the members, I received a number of suggestions for future PASS meetings relating to peace, human rights (especially religious liberty), nuclear disarmament, Catholic international relations theory, governance, and respect for creation. As it happens, all of those topics are within the scope of the historic encyclical *Pacem in Terris* whose 50th anniversary will take place in 2013. Since the Holy See can be expected to be addressing those themes in the context of the anniversary, the Council decided that an ideal way for us to fulfill our statutory duties would be to provide useful materials to the Holy See well in advance of that anniversary. Cardinal Turkson, the new President of the Pontifical Council of Justice and Peace, has expressed great enthusiasm for this idea and promised to cooperate in the planning process.

*Accordingly, it was decided that the 2011 Plenary, which will take place from April 29 to May 3, 2011, will be the first of two Plenaries devoted to preparing materials that may be helpful to the Church in connection with the forthcoming anniversary of Pacem in Terris.*

The 2011 Plenary will focus on freedom of religion, a right that, as Pope John Paul II put it, 'is so closely linked to the other fundamental rights that it can rightly be argued that respect for religious freedom is, as it were, a touchstone for the observance of the other fundamental rights'. In that spirit, the speakers will be asked to take the dilemmas and controversies that have arisen in the area of religious liberty as springboards for reflection on the current crisis of the entire human rights project. In this way, the 2011 Plenary will build on the work of the 2009 Plenary on 'Catholic Social Doctrine and Human Rights', so ably organized by Professors Fumagalli and Possenti.

In response to numerous suggestions from members concerning the need to improve the discussions in the Plenary sessions and to make the results of our work more usable by the Holy See, the Council has instructed the coordinators of the 2011 meeting – Professors Glendon, Kuan, and Zacher – to experiment with major innovations in format.

*2012 and Beyond.* For the continuation of our work on *Pacem in Terris* themes in 2012, the Council has asked Professor Hittinger, in consultation with Professors Matlary and Possenti, to develop a proposal. It is expected that the 2012 meeting will have a strong focus on issues of governance at all levels, on international relations, and on respect for creation. The

Council and the Coordinator would welcome suggestions for topics and speakers. Looking ahead, and in view of the importance of advance planning, all members are urged to think deeply about future programs, and to communicate their thoughts (or, even better, their detailed proposals) to the President and the Council.

\* \* \*

#### *Milestones in 2009-2010*

A notable instance of cooperation between the pontifical academies and departments of the Holy See was the highly successful study day on nuclear non-proliferation organized under the auspices of our sister Academy of Sciences on February 10, 2010, by our Chancellor, Bishop Marcelo Sánchez Sorondo, at the request of Secretary of State Cardinal Tarcisio Bertone. Our fellow academician Luis Derbez Bautista was among the participants in discussions that were designed to aid the Holy See in preparing for the May 2010 Nuclear Non-Proliferation Treaty Review Conference. The proceedings were published as a monograph on 'Nuclear Disarmament, Non-Proliferation, and Development' by the Pontifical Academy of Sciences.

\* \* \*

At the close of our 2010 meeting, Ambassador Suchocka paid eloquent tribute to our dear colleague, Professor Krzysztof Skubiszewski who died in The Hague on February 8, 2010, at the age of 84. A native of Poland, Professor Skubiszewski was a renowned international law scholar whose career encompassed distinguished public service both in Poland and at The Hague. He was Poland's Minister of Foreign Affairs in the period when our colleague Suchocka was Prime Minister, and later became the President of the Iran-US International Claims Tribunal. He was appointed a Member of the Academy in 2002 by Pope John Paul II. We will sorely miss his valuable contributions to our work and his dignified presence at our meetings.

\* \* \*

Finally, it is with great pleasure that I record here the appointment by Pope Benedict XVI of two new members to the Academy, Professor Russell Hittinger and Professor Janne Matlary, both of whom are well-known to the members for their past contributions to our work. We look forward to many years of fruitful collaboration with them.

## INTRODUCTION TO THE SUBJECT AND GOALS OF THE MEETING

JOSÉ T. RAGA

It was not difficult to imagine the theme to which the Plenary Session of the Academy would be devoted in 2010. Three years of severe economic crisis, not to mention the preamble of same, and an enlightening document by H.H. Benedict XVI, the 'Encyclical letter *Caritas in veritate*' proclaimed on 29 June 2009, in which we find an abundance of moral principles on human behaviour, and also on economic matters, gave reason to believe that the Plenary Session which starts today and indeed the Pontifical Academy of Social Sciences would avail itself of the opportunity to reflect on events that have been with us since the beginning of the economic turbulence. These circumstances are still alive and continue to affect people, families, nations and, in general, the world in its most global dimension.

This led the Council of the Academy to propose a year ago that this Plenary Session examine the present crisis in terms of economic and social implications and, above all, with respect to moral principles, involving people and institutions, in both private and public sectors, who through their behaviour participate as active or passive subjects in the gestation of the crisis and, in any case, are affected by its consequences.

Once again, in the same way that occurred at the end of the nineteen twenties, albeit with great differences, the economic agents and those responsible, both then and now, for defining the lines of economic policy, not only preferred to disregard the imbalances being produced in the world economy, but decided to feed them to the very last minute by means of generous funding, with few limits, thereby accelerating an exaggerated growth for the approval of politicians by their electorates. This distorted growth, of necessity, was destined to give rise to an equally distorted recession with profound effects on the economic-financial system and on social cohesion itself. Today this obliges consideration of the responsibility of all agents in

the crisis, as an economic and social phenomenon and, something that is more far-reaching, a reconsideration of the values underlying the behaviour of the subjects that caused their action to have such damaging results for humanity as a whole.

It is true and cannot be forgotten that, for better or for worse, we have created a model of economic relations that acts within a global framework. However, let there be no confusion: this model is no more than an instrument for the achievement of an objective and, as the Holy Father said, 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’.<sup>1</sup>

But the fact cannot be avoided that while globalisation affords the opportunity of quickly transmitting from one country to another or from one continent to the remotest neighbour the favourable effects of an initiative carried out at distances unthinkable in past times, it also transmits the adverse effects of a decision taken in a particular part of the world with the same swiftness and geographic scope.

Benedict XVI, speaking on globalisation, states categorically that: ‘Originating within economically developed countries, this process by its nature has spread to include all economies. It has been the principal driving force behind the emergence from underdevelopment of whole regions, and in itself it represents a great opportunity. Nevertheless, without the guidance of charity in truth, this global force could cause unprecedented damage and create new divisions within the human family’.<sup>2</sup>

At least, the relative disappearance of the barriers which isolated sovereign nations has increased interdependence amongst peoples and nations and has favoured and quickened communication. It is also fair to say that it has tackled necessity by developing conscientious solidarity. At the same time, this disappearance of barriers has transformed nations into elements incapable of protecting themselves and acting with efficiency to combat the unwanted effects that might be produced from another environment, be it far or near.

<sup>1</sup> Benedict XVI, Encyclical letter *Caritas in veritate*, Rome 29.06.2009, n. 36.

<sup>2</sup> Benedict XVI, Encyclical letter *Caritas in veritate*, Rome 29.06.2009, n. 33.

Hence, it can be stated that, in a global world, it is nigh on inconceivable to have a crisis whose effects are only felt in one nation, in one economic sector or in one social segment. Euphoria and depression are transmitted today at an extraordinary speed thanks to modern information and communications technologies and also due to the absence of protective barriers in the economies and societies of the different countries. In this way, the crisis has manifested itself in our global world in the form of a contraction in the growth rates for gross domestic product, which have even reached the point of being negative,<sup>3</sup> a worrying, and in some countries, alarming increase in unemployment,<sup>4</sup> accompanied by a lack of confidence amongst the economic agents in the financial sector and a general feeling of the incapability of the public sector to implement in a timely way the necessary stabilisers that might soften the economic cycle and thus limit the intensity of the crisis and its effects.

To add to all this, the crisis has not had a lesser effect on individuals and families. A sense of confusion and disorientation is to be appreciated in those who suffer it in the cruellest way and in those who do not form part of this group. This feeling is heightened when a consensus of attitudes is

<sup>3</sup> Compared to positive growth rates in worldwide Gross Domestic Product of 5.17% in 2007, the figure fell to 3.00% in 2008 and to the negative rate of -1.06 in 2009. In the advanced economies, growth of 3.00% in 2006 fell to 2.72% in 2007, 0.56% in 2008 and a negative figure of -3.43% in 2009. The figure was -4.19% in the Euro Zone for the latter year. Similarly, the G-7, with an average growth of 2.59% in 2006, saw the rate fall to 2.23% in 2007, 0.27% in 2008 and to a negative figure of -3.63% in 2009. The recently industrialised Asian countries saw their growth rates drop from 5.68% in 2007 to 1.52% in 2008 and to a negative rate of -2.43% in 2009. The emerging and developing economies suffered a significant deterioration, though negative growth rates were not registered. In these economies, growth fell from 8.31% in 2007 to 5.99% in 2008 and 1.70% in 2009; a trend similar to that experienced by Africa and Sub-Saharan Africa. A particularly heavy burden has been borne by Central and Eastern European economies in 2009, with a negative growth rate of -5.04% and also by the economies of the Commonwealth of Independent States with a contraction of -6.73%. Also of note is that the developing Asian countries have experienced least recession, with growth rates of 10.59% in 2007, which fell to 7.58% in 2008 and 6.20% in 2009. [Vide [www.imf.org](http://www.imf.org)].

<sup>4</sup> Unemployment rates in the advanced economies went from 5.39% in 2007 to 8.20% in 2009. Amongst these, the G-7 countries show similar figures with unemployment going from 5.45% in 2007 to 8.24% in 2009. The Euro Zone shows the highest increase in unemployment rates, going from 7.50% in 2007 to 9.90% in 2009. Once again, the available data indicates that the recently industrialised Asian countries have had the lowest increase in unemployment rates, with the figure rising from 3.42% in 2007 to 4.55% in 2009. [Vide [www.imf.org](http://www.imf.org)].

not perceived on the part of those responsible for economic policy at national and international levels. At times there are affirmations that the crisis is the consequence of a free market without restrictions and without intervention. At the same time, there is reflection on the determining role played by the financial sector in the intensity of the crisis, a sector which, it has to be acknowledged, is perhaps the most regulated of all, with specific bodies for regulatory control and enforcement of strict compliance.

The impression is of man wandering from place to place in search of an answer to his worries. Uneasiness in an accelerated and sterile search for technical solutions to his anguish adds to the depression which invades him personally and also invades all members of the family. It is true that all human action, according to Mises, can be considered economic action, insofar as the subject carries out this action for the purpose of improving the current situation, in a framework of uncertainty, in which foresight is brought to bear though it may be erroneous. In the words of the Austrian economist, 'Acting man is eager to substitute a more satisfactory state of affairs for a less satisfactory. His mind imagines conditions which suit him better, and his action aims at bringing about this desired state. The incentive that impels a man to act is always some uneasiness'.<sup>5</sup> It is no less certain, if we take Benedict XVI, that: '*...economic activity...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...*'.<sup>6</sup> From here, it would be easy to infer that in all probability the technical solution to the crisis will not be isolated from a human solution, from a vision of man and his mission, from a communal responsibility of the entire human family which is today, as could not be otherwise, a global family.

In the words of Benedict XVI, '...the crisis, its solutions, and any new development that the future may bring...require new efforts of holistic understanding and a *new humanistic synthesis*. The complexity and gravity of the present economic situation rightly cause us concern, but we must adopt a realistic attitude as we take up with confidence and hope the new responsibilities to which we are called by the prospect of a world in need of profound cultural renewal, a world that needs to rediscover fundamental

<sup>5</sup> Ludwig von Mises *Human Action. A Treatise on Economics*. William Hodge and Company Limited. London/Edinburgh/Glasgow 1949; p. 13.

<sup>6</sup> Benedict XVI, Encyclical letter *Caritas in veritate*, Rome 29.06.2009, n. 37.

values on which to build a better future. The current crisis obliges us to re-plan our journey, to set ourselves new rules and to discover new forms of commitment, to build on positive experiences and to reject negative ones. The crisis thus becomes *an opportunity for discernment, in which to shape a new vision for the future*. In this spirit, with confidence rather than resignation, it is appropriate to address the difficulties of the present time'.<sup>7</sup>

The text of Benedict XVI awakens in the scientific world, in the interdisciplinary context that is to be perceived in all crises, the restlessness in the search for causes which almost certainly will not be found in a restricted, mono-disciplinary scenario, but on the contrary will manifest themselves as a series of co-causes ranging from the strictly technical to the most intimately human and linked to the values which preside over the actions of men in a community desired to be ordered and just. On this occasion, to discern and plan a new way of life for citizens, something which has led the Pontifical Academy of Social Sciences to undertake a profound study of the current crisis. This study has a wide vision, which seeks to contemplate the technical-economic aspects along with the social, educational and moral aspects, so that the commitment to man helps us see, with clarity and hope, the moment of despair being experienced by a large portion of the world population, in a *manner more confident than resigned*, as the pontifical text so succinctly expresses it.

A commitment to humanity present in the Church since the beginning of time. John XXIII stated clearly both the tasks of a spiritual order and those of a material order which, with respect to man, constitute the mission of the Church. In his words, 'Hence, though the Church's first care must be for souls, how she can sanctify them and make them share in the gifts of heaven, she concerns herself too with the exigencies of man's daily life, with his livelihood and education, and his general, temporal welfare and prosperity'<sup>8</sup> Paul VI, ten years later, would state that 'The Church...travels forward with humanity and shares its lot in the setting of history'.<sup>9</sup>

#### THE ORGANISATION OF THE PLENARY SESSION

The XVI Plenary Session of the Pontifical Academy of Social Sciences, to take place between April 30 and May 4 2010 in order to address the topic of

<sup>7</sup> Benedict XVI, Encyclical letter *Caritas in veritate*, Rome 29.06.2009, n. 21.

<sup>8</sup> John XXIII, Encyclical letter *Mater et magistra*, Rome 15.05.1961, n. 3.

<sup>9</sup> Paul VI, Apostolic letter *Octogesima adveniens*, Vatican 14.05.1971, n. 1.

'The Crisis in a Global Economy', will bring together scientific contributions from forty-two expert professors, either in the form of speakers or commentators. All are specialists in the different areas encompassed by the theme of the study. I would like to acknowledge publicly here what a privilege it is for the Academy to be in a position to avail itself of such contributions. At the same time, I would like to express my gratitude for the goodwill shown by all with respect to assuming responsibility for their presence and also for their contribution. I would also like to express my gratitude to the Council of the Academy for their confidence in entrusting me with the organisation of this Plenary Session and to each of the persons of which its administrative structure is composed, under the management of its Chancellor, H.E. Mgr. Marcelo Sánchez Sorondo, to whom I express particular gratitude for his enormous help, without which this event would not have been possible.

The Session as a whole, and the themes to be presented in each of its sections, has been divided into three main thematic groups, with the presentations being distributed into each group. Following the Inauguration Session, with the lesson by H.E.m. Card. Peter Kodwo Appiah Turkson, the first group will take place between April 30 and the beginning of May 1 – until 11.30 – and will be entitled *Where Do We Stand? The Impact of the Crisis on Persons and Institutions*. This will analyse the Crisis at this very moment in time. The study will take into consideration both economic aspects *strictu sensu*, from the perspective of economic theory and policy, as well as aspects corresponding to society in the sense of the community of people. The former will naturally include the economic effects of the crisis on people and on society as a whole, with very special consideration being given to the developing countries, a cause of particular concern to the Church as well as to the Academy and its members. A reference present throughout the tradition of what today constitutes the *corpus* of the Social Doctrine of the Church is repeated. John Paul II tells us that: 'Church's love for the poor, which is essential for her and a part of her constant tradition, impels her to give attention to a world in which poverty is threatening to assume massive proportions in spite of technological and economic progress'.<sup>10</sup>

Along with economic aspects in the strict sense, the human and social areas will concentrate on the moral principles that guide the behaviour of people and which, perhaps because they have been forgotten, have offered wide scope to the gestation of the 'crisis' phenomenon and its conse-

<sup>10</sup> John Paul II, Encyclical letter *Centesimus annus*, Rome 01.05.1991, n. 57.

quences. This consideration leads us to the view that a community without values for co-existence is a disintegrated group of men and women which, because it lacks the bonds of belonging, also lacks the awareness of interdependence, making the existence of a community impossible because there is nothing in common. In essence, the inexistence of a civil society with responsibility or solidarity manifests itself as the most significant shortcoming. The operative model is that of the State on the one hand, as an organic superstructure holding power, and on the other hand, that of the individuals, individual persons without horizontal links to connect and bring them close to the other members of the group.

The second thematic group, entitled *How Did We Get to this Point? The Decisive Contributing Factors*, will occupy the study from 12.00 pm on May 1, until the end of the day. There will be an analysis of how the crisis situation was reached; what humanity has done and who in humanity developed attitudes which led to the unfolding of the crisis. Furthermore, of concern in the study of this process leading to the crisis will be whether the result was one produced by destiny, without specific responsibility for deliberately adverse behaviour or if, on the contrary, the result was the logical consequence of desires, actions and objectives which, fixed by certain individual or collective agents for their exclusive benefit, were at the same time damaging to the entire human family, sowing the seeds of chaos and desperation in the people.

The initial perspective of the crisis does not permit the exclusion of anybody from our consideration. In all or in a large number of the actors on the economic stage, conduct may be found in which some responsibility for the gestation of the crisis or the deepening of it might be perceived. Therefore, the analysis of conduct and responsibilities is focused on all the economic agents, without exception. This is true regardless of a possible acknowledgement that, though the specific conduct might have played a part in the unfolding of the economic chaos, the level of responsibility can be differentiated in accordance with the influence the conduct might have had on the result and, above all, the objectives behind such conduct.

Therefore, in this second group of presentations, a study will be made of the actions and decisions of people and families, both as demanders of goods and services, as well as suppliers of work, a qualified resource for the productive system. Naturally, when we speak of the demand for goods, we include both consumer goods, investment goods and consumer durable goods.

Along with people and families, the decisions of the business sector are of significance, insofar as its perception of market needs is translated to the

economic sector, accelerating or slowing down economic activity accordingly. It is clear that behaviour can exacerbate the imbalances of the system and there is *prima facie* evidence to suggest that something along these lines may have occurred. The assessment is quite different if the adverse business behaviour is due to erroneous perception, something to which nobody is immune, or if, on the contrary, the business community, lured by immediate or short-term profit, opted for a course of action damaging to the community and the economic system itself, although the business community is itself among the victims. Naturally we are speaking of the responsibility or irresponsibility of the agents in their economic activity.

The role of the financial sector in the current crisis is deserving of special consideration, precisely due to its activity in the creation of means of payment and financing which, in some way, may have served to feed the crisis situation, accentuating its effects, with more damaging results for the sector itself than those that would have been produced by a recession in the real sector of the economy. The greatest damage to the financial sector has manifested itself in the lack of confidence that has arisen in the sector itself and in its institutions, to the point of halting its functioning at a global level.

The issuing of securities – derivatives – of great opaqueness, and their universal distribution through the financial markets, has led to the bankrupting of the system and that of the families and companies who had placed their trust and their savings in that system. And, along with the financial sector, an analysis must be made of all the institutions whose purpose is precisely that of endowing the money market and its instruments with the guarantee that facilitates the necessary confidence, when goods and services of little transparency are being sold on the market. We are naturally referring to the regulators, to those whose mission it is to control the efficiency of the regulation, to those who through their judgements and opinions underwrite the public faith in the financial state of entities, companies and institutions – accounting and managing auditors – and also those who publicly certify the solvency of the entities that issue securities, both fixed and variable yield – rating agencies – for the information and confidence of those who operate in the financial market.

It is obvious that all the behaviour of those to whom we are referring may have been erroneous at a given moment in time and that such error might have damaging effects on the economy of the global nation. However, it is no less true that along with the risk of error, decisions may have been affected by the blindness produced by the immediate profit of a few to the detriment of humanity as a whole. Furthermore, it may be the case that if

such blindness existed, it may have changed the basic postulates and very functioning of the financial sector and indeed financing itself. A function which is none other than to serve the development of the real economy: a function which in specific terms is the placing in the market of the means of payment necessary, and only those necessary, to allow the real economy to operate speedily and with stable prices.

This function is lost when the financial economy becomes the centre of itself, detached from the needs of the real economy and acting as a constraint on its very development. Benedict XVI warned that ‘...*Finance*, therefore – through the renewed structures and operating methods that have to be designed after its misuse, which wreaked such havoc on the real economy – now needs to go back to being an *instrument directed towards improved wealth creation and development*. Insofar as they are instruments, the entire economy and finance, not just certain sectors, must be used in an ethical way so as to create suitable conditions for human development and for the development of peoples... Financiers must rediscover the genuinely ethical foundation of their activity, so as not to abuse the sophisticated instruments which can serve to betray the interests of savers. Right intention, transparency, and the search for positive results are mutually compatible and must never be detached from one another’.<sup>11</sup> A call which is a good gateway for reflection.

Reflection is also demanded of the public sector in that its performance in tackling the crisis, at times motivated by electoral objectives or yielding to the pressure of economic, political or social lobbies, endangers the structure and commitments of the welfare state itself, with more serious consequences for the less well off, whilst also tainting the nobility of the exercising of political action for the common good. The good of man, of all mankind and all men. For this reason, in this thematic group, special emphasis is given to the consideration of developing countries, that is to say, poor countries.

Finally, the third group of presentations, entitled *How Do We ‘Re-plan the Journey’?*, seeks the way out of the present situation, both from a technical perspective and the perspective of the moral principles that influence the conduct of individual subjects, and both with respect to the personal private dimension and the public or institutional dimension. This will take place during 3 and 4 May. The objective is to judge, by means of

<sup>11</sup> Benedict XVI, Encyclical letter *Caritas in veritate*, Rome 29.06.2009, n. 65.

prior analysis, the modification of behavioural structures and norms that has led to the current state of economic crisis, which has hit systems, nations and peoples with extreme burden. It is natural that the Academy, and also the world population suffering the effects of crisis, should ask about the constraints on economic activity – the regulatory framework –, about the efficiency of the measures and, ultimately, about the public authority itself, as guarantor of the functioning of a system, on the one hand in terms of compliance with regulation and, on the other hand, with respect to the fact that in its free dimension, the market can only operate in an ordered and just world.

Therefore, in this section, we question ourselves with respect to the scope of a correct regulation for the achievement of the desired objectives. That is to say, what type of regulation is needed to guarantee the functioning of the system and, at the same time, to protect it from the possible abuses of those agents operating within it. What are the moral principles that should preside over the behaviour of individuals and families as decision makers in the consumption units and what are the principles that should govern those persons in charge of the production units, i.e., business people.

Never before has there been so much talk of the ethics of behaviour and it would seem that never have we been further from those ethical principles that lend nobility to the conduct of a community and those who make it up. There is incessant talk of fair prices, of fair trade, of ethical funds, of ethical loans, but, on the other hand, we cannot but ask ourselves, in view of recent events, about the concept of ethics we are taking as a reference. Benedict XVI has outlined it thus: ‘...Today we hear much talk of ethics in the world of economy, finance and business. Research centres and seminars in business ethics are on the rise; the system of ethical certification is spreading throughout the developed world as part of the movement of ideas associated with the responsibilities of business towards society. Banks are proposing “ethical” accounts and investment funds. “Ethical financing” is being developed, especially through micro-credit and, more generally, micro-finance... Their positive effects are also being felt in the less developed areas of the world. It would be advisable, however, to develop a sound criterion of discernment, since the adjective “ethical” can be abused. When the word is used generically, it can lend itself to any number of interpretations, even to the point where it includes decisions and choices contrary to justice and authentic human welfare’.<sup>12</sup>

<sup>12</sup> Benedict XVI, Encyclical letter *Caritas in veritate*, Rome 29.06.2009, n. 45.

In this matter, as in so many others, the developing countries have a voice that must be heard with special attention and with the vocation to respond. A response that is demanded of individual persons but also of the public authorities. The world has changed substantially. In the age of globalisation, the effects of action in one territory determined by a jurisdiction is felt in the rest of man's domains and jurisdictional States. It is difficult to accept from the outset that a model of the sovereign State, designed to exercise its authority over a defined area protected by boundaries, continues to be valid in an era in which such protection does not exist and in which effects are transmitted with such extraordinary speed from one part of the globe to another.

The authority to govern the global world will surely demand the type of profiles that are not to be found in those who have been governing the world with borders. Is a world authority possible? Might it be possible to constitute a world authority and thereby make the family of nations a reality?<sup>13</sup>

In this group of matters, we shall also benefit from the presence of outstanding and significant actors in the real world of the economy. These will be divided into three discussion panels; one devoted to the financial sector and the other two to the real sector, which will enable first-hand knowledge of the intricacies of decision-making, its most significant parameters, including education, and the risks it confronts in an uncertain world, such is the world of the economy and economic decisions.

I would like to think that at the end of the fourth of May, when we have concluded the Sixteenth Plenary Session, we will all have become enriched with a knowledge of the facts, the opinions, the constraints, and the possible roads to the solution of a phenomenon, the *Crisis in the Global Economy*, which has greeted us at the beginning of the twenty-first century and has perturbed humanity as a whole.

<sup>13</sup> *Vide* Benedict XVI, Encyclical letter *Caritas in veritate*, Rome 29.06.2009, n. 67.

## PROGRAMME

16th PLENARY SESSION • 30 APRIL-5 MAY 2010

FRIDAY, 30 APRIL 2010	
9:00	<i>Words of Welcome by the President Prof. Mary Ann Glendon</i>
9:15	<i>Introduction to the Subject and Goals of the Meeting</i> ◆ <b>Prof. José T. Raga</b>
9:30	<i>The Social Doctrine of Benedict XVI in Caritas in Veritate</i> ◆ <b>H.E.M. Card. Peter Kodwo Appiah Turkson</b>
10:30	Coffee break
11:15	<b>Papal Audience</b>
13:00	Lunch at the Casina Pio IV
<b>WHERE DO WE STAND? THE IMPACT OF THE CRISIS ON PERSONS AND INSTITUTIONS</b>	
14:20	Chair: <b>H.E.M. Card. George Pell</b> Speakers: ◆ <b>Prof. José T. Raga</b> <i>General Overview of the Magnitude of the Crisis: The Global Comments</i> Commentator: ◆ <b>Prof. Jörg Guido Hülsmann</b>
15:30	Discussion
16:00	Chair: <b>H.E.M. Card. George Pell</b> Speakers: ◆ <b>Prof. Margaret S. Archer</b> <i>The Current Crisis: The Result of Neglecting the Four Key Principles of Catholic Social Doctrine</i> ◆ <b>Prof. Pierpaolo Demati</b> <i>The Crisis of the 'World System' and the Need for a New Civil Society</i> Commentator: ◆ <b>Prof. Russell Hittinger</b>
17:15	Discussion
17:45	Coffee break
18:15	Chair: <b>Prof. Juan José Llach</b> Speakers: ◆ <b>Prof. Belisario Betancur</b> <i>Effects of the Crisis in Developing Countries</i> ◆ <b>Prof. Paulus Zulu</b> <i>Effects of the Crisis in Developing Countries</i> Commentator: ◆ <b>Prof. Luis Ernesto Derbez Bautista</b>
19:30	Discussion
20:00	Dinner at the Casina Pio IV

**SATURDAY, 1 MAY 2010**

09:00	Chair: <b>Prof. Hsin-chi Kuan</b> Speakers: <ul style="list-style-type: none"> <li>◆ <b>Prof. Partha S. Dasgupta</b> <i>Sub-Saharan Africa: Demographic and Environmental Consequences of Increased Vulnerability Among the World's Poorest</i></li> <li>◆ <b>Prof. Angelika Nuffberger</b> <i>Regulation, Regulators, Controllers and Governments</i></li> </ul> Commentator: <ul style="list-style-type: none"> <li>◆ <b>Prof. Jaume Hanland Matlary</b></li> </ul>
11:00	Discussion
11:30	Coffee break
<b>How Did We Get to This Point? The Decisive Contributing Factors</b>	
12:00	Chair: <b>Prof. Hsin-chi Kuan</b> Speaker: <ul style="list-style-type: none"> <li>◆ <b>Prof. Louis Sahourin</b> <i>Réflexions à propos des effets de la crise économique mondiale sur les enfants handicapés et les populations</i></li> <li>◆ <b>Dr. Klaus Liebscher</b> <i>The Crisis in the Public Sector: Budget Implications for the Welfare State</i></li> </ul> Commentator: <ul style="list-style-type: none"> <li>◆ <b>Res. Prof. Helen Allard</b></li> </ul>
13:00	Discussion
13:30	Lunch at the Casino Pao IV
15:00	Chair: <b>Prof. Pierpaolo Dumati</b> Speakers: <ul style="list-style-type: none"> <li>◆ <b>Prof. Hans-Werner Sinn</b> <i>The Crisis: Risks and Lessons</i></li> <li>◆ <b>Prof. Stefano Zamagni</b> <i>On the Remote Causes of a Foretold Crisis: When Economics Deviates from the Ethics of Virtue</i></li> </ul> Commentator: <ul style="list-style-type: none"> <li>◆ <b>I.L.E. Magr. Mario Toso</b></li> </ul>
16:15	Discussion
16:45	Coffee Break
17:15	Chair: <b>Prof. Pierpaolo Dumati</b> Speakers: <ul style="list-style-type: none"> <li>◆ <b>Prof. Kevin Ryan</b> <i>Persons and Families as Consumers and as Labour Suppliers</i></li> <li>◆ <b>Prof. Lubomír Mlčoch</b> <i>Business Leadership since specific determinants: responsibility in a Global Space</i></li> </ul> Commentator: <ul style="list-style-type: none"> <li>◆ <b>Prof. Michael Novak</b></li> </ul>
18:30	Discussion
19:00	Dinner at the Casino Pao IV

**SUNDAY, 2 MAY 2010**

9:30	Departure from the Dennis Sanchez Marche
10:30	Holy Mass at the Catacombs of St Sebastian
11:30	Visit to the Catacombs of St Sebastian
13:00	Lunch at the Casino Pio IV
19:00	Dinner at the Casino Pio IV

**MONDAY, 3 MAY 2010****HOW DO WE REPLAN THE JOURNEY?**

9:00	Chair: <b>Prof. Louis Sabourin</b> Speakers: <ul style="list-style-type: none"> <li>◆ <b>Prof. Hans Tietmeyer</b> <i>What Kind of Regulation?</i></li> <li>◆ <b>Prof. Herbert Schrambeck</b> <i>Is the Global Authority a Feasible Solution?</i></li> </ul> Commentator: <ul style="list-style-type: none"> <li>◆ <b>Prof. Basco Buttiglione</b></li> </ul>
10:15	Discussion
10:45	Coffee break
11:15	Chair: <b>Prof. Louis Sabourin</b> Speakers: <ul style="list-style-type: none"> <li>◆ <b>Prof. Juan José Llach</b> <i>The Crisis, its Aftermath and the New Role of Designing Countries</i></li> <li>◆ <b>Prof. Vittorio Pissenti</b> <i>The Governance of Globalization: Global Political Authority, Solidarity and Subsidiarity</i></li> </ul> Commentators: <ul style="list-style-type: none"> <li>◆ <b>Prof. Hsin-chi Kuan</b></li> <li>◆ <b>Prof. Hans Zacher</b></li> </ul>
12:30	Discussion
13:00	Lunch at the Casino Pio IV
15:00	Chair: <b>Prof. Hans Tietmeyer</b> Panel on <i>Financial Markets</i> <ul style="list-style-type: none"> <li>◆ <b>Prof. Lucas Papademos</b>, European Central Bank</li> <li>◆ <b>Prof. Mario Draghi</b>, Governor of the Bank of Italy</li> <li>◆ <b>Dr. Ettore Gotti Tedeschi</b>, President of Istituto per le Opere di Religione</li> </ul>
16:45	Discussion
17:15	Coffee break
17:45	Chair: <b>Prof. Margaret Archer</b> Speakers: <ul style="list-style-type: none"> <li>◆ <b>H.E. Msgr. Prof. Roland Minnerath</b> <i>Personal and Family Decisions in a Scenario of Uncertainty</i></li> <li>◆ <b>Prof. Vittorio Hösle</b> <i>Ethics and Economics: New Constitutions for Entrepreneurs</i></li> </ul> Commentator: <ul style="list-style-type: none"> <li>◆ <b>Prof. Mino Ramírez</b></li> </ul>
19:00	Discussion
19:30	Dinner at the Casino Pio IV

**TUESDAY, 4 MAY 2010**

9:00	<b>Chair: Pres. Prof. Mary Ann Glendon</b> <i>Panel on The Production Sector</i> ◆ <b>Minister President Peter Harry Carstensen</b> , renewable energy sector ◆ <b>Dr. Joachim von Braun</b> , food and agriculture change ◆ <b>Dr. Luca Cordero di Montezemolo</b> , automobile industry
11:00	Coffee break
11:30	<b>Chair: Prof. José T. Raga</b> <i>Panel on The Production Sector</i> ◆ <b>Dr. Patrick Adenauer</b> , construction industry ◆ <b>Pres. Prof. Mary Ann Glendon</b> , higher education
13:15	Lunch at the Casino Pío IV
15:00	Conclusions and General Discussion
16:30	Coffee break
17:00	Closed Session for Academicians
19:00	Dinner at the Casino Pío IV

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# THE SOCIAL DOCTRINE OF BENEDICT XVI IN *CARITAS IN VERITATE*

PETER KODWO APPIAH TURKSON

## INTRODUCTION

It has been my pleasure to participate in this five-day Conference of the Pontifical Academy of Social Sciences; and I am grateful to Cardinal Bertone, whose inability to be here with you has given me this enviable opportunity to address you and to share some thoughts with you on the great social teaching, *Caritas in Veritate*, of our Holy Father: Pope Benedict XVI.

This Pontifical Academy, as I have been told, is the ‘think tank’ of the *Pontifical Council for Justice and Peace*, to which I belong; and I hope that this occasion will mark a new strengthening of the already close cooperation between this Pontifical Academy and the Pontifical Council for Justice and Peace, as the two Pontifical bodies help the Holy Father in his leadership of the Church and in his dual mission of *Shepherd* and *Teacher*.

Clearly, recent global events awaken us to the importance of a sustained Christian reflection on the nature and goal of human development and economic life, both within our own society and in other parts of the world. It is in this context that Pope Benedict XVI, keenly aware of the dynamics of globalization and its impact on the human family, issued his third and greatly anticipated<sup>1</sup> Encyclical Letter *Caritas in Veritate*.

Here in the next few days, the distinguished members of this Academy will engage in learned discussions on some key elements of the Church’s

<sup>1</sup> The reception of the encyclical has been great. It is a document that appears to have something for everybody to identify with. Within thirty (30) days of its publication, Vatican Radio counted about 4,300 articles on the encyclical in English, French, Italian, Spanish and Portuguese on the web. The *Meltwater Group*, extending its survey to other languages, counted 6,000 articles on the encyclical (cfr. Gianpaolo Salvini S.J., *Enciclica Caritas in Veritate*, in *La Civiltà Cattolica*, (#3822, 19 Sept. 2009), 458.

social doctrine, especially as this encyclical letter, *Caritas in Veritate*, articulates it. You will articulate, in your turn, not only the challenges that we face as a human family, but also the hope offered by a more fulsome integration of sound Christian, and indeed human, principles capable of guiding humanity toward a better future. You will thus seek to wrestle with and respond to *Caritas in Veritate*, and its identification of the twin call of *love* and *truth* upon our lives as citizens, professors, researchers, opinion-makers, entrepreneurs, and, most fundamentally, as *followers of Christ* and *subjects of reason*.

Allow me now to make only a few observations, namely, on the encyclical as a Social Teaching, its papal authorship, its appeal to *faith* and *reason*, some of its main themes and some of its striking features, which may help our regard of the encyclical and stimulate some more study of it in our days together and hereafter.

#### *CARITAS IN VERITATE*, A PAPAL TEACHING AND A TEACHING POPE

##### *A Papal Teaching*

Announced in 2007, on the occasion of the 40th anniversary of the encyclical letter *Populorum Progressio* of Pope Paul VI (1967) and the 20th anniversary of the encyclical letter *Sollicitudo Rei Socialis* of Pope John Paul II (1987), *Caritas in Veritate* was originally intended to celebrate the memory of these two encyclicals, especially for their treatment of the question of *development*. *Caritas in Veritate* originally intended to take up the issue of *development* in the new and changed situation of a *globalized world*. What was once a simple *social issue* in the days of Pope Paul VI and Pope John Paul II has now become a *global issue*. The incidence of the economic crisis of 2008-2009 invited the Pope to treat the issue and the ethics of *economics in the context of human development* in greater details. This delayed the completion of the encyclical letter somewhat; but on 29th June 2009 (feast of Sts. Peter and Paul), the Pope signed the new social encyclical and promulgated it on 7th July 2009 (month of St. Benedict), just before the meeting of the G-8 in L'Aquila, Italy.

*Caritas in Veritate* is a social encyclical like very many others before it, beginning with Pope Leo XIII's *Rerum Novarum* (1891).<sup>2</sup> In it the insights of

<sup>2</sup> Counting the letter of the *Sacred Congregation of the Council* to Msgr. Liénart, Bishop of Lille, on 5 June 1929, two documents of Vatican Council II: *Gaudium et Spes* and

theology, philosophy, economics, ecology and politics have been harnessed coherently to formulate a social teaching<sup>3</sup> that places the human person (his total and integral development) at the centre of all world systems of thought and activity. The human person (his salvation) was at the centre of the mission and ministry of Jesus Christ: as the *revelation of the love of the Father* (Jn 3:16) and *the truth of man's creation in God's image and of his transcendent vocation to holiness and to happiness with God*. This is the setting of the two concepts: *love and truth*, which drive the encyclical. *Love and truth* do not only lie at the heart of the mission and ministry of Jesus; they also correspond to and describe the essential character of the life of the human person on earth, namely, as a *gift and love of God to become gift and love too*.

In specifying *love and truth* as the premise and scope of human development, the encyclical may appear to be idealistic; but 'this is a method the Social Teachings of the Church constantly follow, namely: to take the high road, not to distance us from reality, but to draw our attention to the essential point. It is then up to individuals, in their countries, in their profession, in their personal life, to follow through with concrete practice'.<sup>4</sup> This dynam-

*Dignitatis Humanae*, the second half of the encyclical letter, *Deus Caritas Est*, and the Instruction *Dignitas Personae*, on certain bioethical questions, from the Congregation for the Doctrine of the Faith (8 Dec. 2008), one may reckon with twenty two (22) official documents on the social teaching of the church (cfr. *Le Discours social de l'Eglise Catholique: De Léon XIII à Benoît XVI*, Bayard Montrouge 2009). On the various use of *Encyclicals* by the Popes, *Wikipedia's* entry on the matter (*Papal use of Encyclicals*) is useful. While some Popes have made use of *Encyclicals* to address issues of social concern, others have simply made use of addresses/speeches at *Papal Audiences*.

<sup>3</sup> A true understanding of the nature of the Church's Social Doctrine starts with the faith experience of the ecclesial community itself. Following their response to God's revelation of his love and truth in Jesus, the Word-made-flesh, people are transformed, re-socialized by the power of God's word and love. This new social reality, the ecclesial community, celebrates and announces the love and truth of the Trinitarian life which surrounds and embraces it (*Caritas in Veritate*, n. 54). From this experience, people become subjects of love and of truth, subjects of new freedom and new way of thinking, called to become instruments of grace and communion, spreading the Good News of God's love and weaving networks of love and of truth (*CV*, n. 5). This *baptismal* experience of life of the ecclesial community does not close in on itself; but it interacts at every level with the world. It is in living in Jesus, the Supreme Truth and Good, that the faithful discover anew an appropriate order of goods, an authentic scale of values and a new set of ethical criteria which honour the profound change which they seek to witness.

<sup>4</sup> 'C'est une méthode constant de la doctrine social de l'Eglise: prendre de la hauteur, non pour nous éloigner de réel, mais pour nous rapprocher de l'essentiel. Ensuite, à chacun, dans son pays, dans son métier, dans sa vie personnelle, d'en tirer les conséquences pratiques'. (J.-Y. Naudet, *Caritas in Veritate*. La doctrine sociale de l'Eglise: 'un unique enseignement, ...', *Annales de Vendée* n. 5 [2009] 140).

ic of charity received and given is what gives rise to the Church's Social Teaching, which is *Caritas in Veritate in re sociali*.<sup>5</sup>

Human society, the reference of the Church's Social Teaching, has changed over the years: from the misery of workers in the days after the industrial revolution and the emergence of Marxism (Pope Leo XIII), the crisis of 1929 (Pope Pius XI), decolonization and appearance of third-worldism (Pope John XXIII and Pope Paul VI), the fall of the Berlin wall and political changes in Eastern Europe (Pope John Paul II) to globalization, under-development, financial, economic, moral and anthropological crises<sup>6</sup> of Pope Benedict XVI. In these changing situations, the social encyclicals of the Popes have fulfilled the need to actualize the same principles of the Church's Social Teaching. 'The Church's social doctrine illuminates with an unchanging light the new problems that are constantly emerging'.<sup>7</sup> From illuminating merely social problems and challenges in the past, the Church's social doctrine, in *Caritas in Veritate*, illuminates *social, global, economic, entrepreneurial, political, anthropological and ecological* problems and challenges of our world-society.

Thus *Caritas in Veritate* preserves the tradition of the Pope or Church Councils, presided over by the Pope, offering teachings, which reflect the prophetic and teaching office of the Pope and which are meant to guide the Church's living of the Gospel's values and message in the world (social doctrine). In this sense, Pope Pius XII is believed to have held that Papal Encyclicals, even when they are not *ex cathedra*, can nonetheless be sufficiently authoritative to end theological debate on a particular question.<sup>8</sup>

### *A Teaching Pope*

This long tradition of papal teaching does not only locate *Caritas in Veritate* in the living stream of Church life and practice. It also roots the figure

<sup>5</sup> *Caritas in Veritate*, n. 5.

<sup>6</sup> Cfr. *ibid.* n. 75.

<sup>7</sup> Cfr. *ibid.* n. 12; *Sollicitudo rei Socialis*, n. 3.

<sup>8</sup> 'It is not to be thought that what is set down in Encyclical letters does not demand assent in itself, because in this the Popes do not exercise the supreme power of their magisterium...; usually what is forth and inculcated in Encyclical Letters, already pertains to Catholic doctrine. But if the supreme Pontiffs in their acts, after due consideration, express an opinion on a hitherto controversial matter, it is clear to all that this matter, according to the mind and will of the same Pontiffs, cannot any longer be considered a question of free discussion among theologians' (*Humani Generis*, n. 20).

of the *teaching Pope* equally deeply in the Church's life and history; and the significance of this may not be overlooked.

As the author of an encyclical, the Pope is a religious figure, constituted *pastor, leader, prophet* etc., according to the faith of the Church, by Jesus Christ, the Son of God and founder of the Church. Like the Apostle Peter, his predecessor, whom he succeeds in the pastoral care of Christ's sheep and lambs (*Jn 21:15-17*), the Pope shares in Christ's prayer for Peter: '*I have prayed for you that your faith may not fail; and you...strengthen your brothers*' (*Lk 22:31-32*). As the spiritual and pastoral leader of the Catholic Church, the Pope is prayed for universally by the Church. No Eucharist is celebrated without a prayer for the Pope; and he is himself a man of deep personal prayer,<sup>9</sup> who seeks God's face and the mind of Christ (cfr. *1 Cor 2:16*) in prayer. Like the Church which he is *made a pastor of by Jesus* (*Jn 21:16-17*), the Pope is, therefore, a figure in whom heaven and earth meet, and whose mission is to form and inform the earthly with the heavenly. He is a figure who represents an *openness* to the divine and the transcendent, and who accordingly invites the world to a similar experience of openness to the transcendent and the divine. His is a leadership that is exercised in the power of the Spirit; and it is rooted in the long and ancient tradition of the exercise of religious leadership in Scriptures and in the history of the Church. Thus, like the prophets of old, the Pope cultivates an *openness* to God during which '*his ears are awakened*' (*Is 50:4-5*) to hear a saving message for humanity and the world, and during which '*the Lord gives (him) the tongue of a teacher to sustain the weary with a word*' (*Is 50:1*). He can be resisted and rejected, persecuted and disgraced, but for this, he is also given a '*flint face*' (cfr. *Is 50:7; Ezek 3:9*) to teach '*in and out of season*' (*2 Tim 4:2*).

This is not an *apologia* for the Pope. It is what Roman Catholics believe about their leader and Pope who teaches them and all men and women of good will in *Caritas in Veritate*, the encyclical under study.

#### THE ENCYCLICAL'S APPEAL TO FAITH AND REASON

*Caritas in Veritate*, like all the other social encyclicals, is addressed to Catholics and non-Catholics: all men and women of good will. Recogniz-

<sup>9</sup> Cfr. E.g. The prayer life of Pope John Paul II in: *Varcare la Soglia della Speranza*, Arnoldo Mondadori, Milano 1994, pp. 20-26.

ing the pluriformity of confessions and mental postures (agnostics, atheists, free thinkers etc.) in human society, the social encyclicals seek to invite all the components of society to come together to develop a more human and better society.

The two basic groups addressed, Catholics and non-Catholics (men and women of good will), also explain the encyclical's reference and appeal to *faith* and *reason*: *faith* for those who believe in Christ, and *reason* for non-believers. Thus the Pope reminds us that the Social Doctrine of the Church is a 'truth of faith and of reason'.<sup>10</sup> Indeed, the dynamic of charity received and given, which gives rise to *Caritas in Veritate in re sociali* is the proclamation of the truth of Christ's love in society; and it is rooted in truth: the truth of faith and of reason.<sup>11</sup> For, just as a person, on the order of nature, is led by the light of reason to the discovery of natural law, to the understanding of rights of people and to a reflection on social issues, so are Christians, as objects of God's love and on the order of grace, called upon to become subjects of charity, pouring forth God's charity and weaving networks of charity. So, the underlying affirmation of social encyclicals addressing Catholics and men and women of good will is the perfect compatibility between faith and reason, even if faith always challenges reason to open up to transcendence. Thus, though distinct in their cognitive characters and fields, faith and reason still converge in *Caritas in Veritate* and in the other social encyclicals to cast their *prophetic* regard on society, on its institutions and on its structures, condemning ideologies and social systems which deny humanity its freedom and dignity, and affirming those which promote the true nature of the human person, for example, by supporting justice with the culture of love to establish a civilization of love and to uphold the primacy of *ethics* over and all forms of manipulation of life, utilitarianism, economics and politics.

#### OBSERVATIONS ON SOME THEMES OF THE ENCYCLICAL

##### *An Integral Model of Human Development*

*Caritas in Veritate* proposes an integral model of human development in the context of globalization, 'the expansion of worldwide interdependence', and calls for a 'person-centred and community-oriented process of integra-

<sup>10</sup> *Caritas in Veritate*, n. 5.

<sup>11</sup> Cfr. *ibid.*

tion'. As has been aptly pointed out in these days, although globalization has indeed lifted millions of people out of poverty, primarily by the integration of the economies of developing nations into international markets, the unevenness of this integration leaves us deeply concerned about the flagrant disregard for human dignity, inequality, poverty, food insecurity, unemployment, social exclusion, violations of religious freedom, and materialism that continue to ravage human communities, with destructive consequences for the future of our planet and for our human family.<sup>12</sup>

A key element of *Caritas in Veritate*, and one that Catholic social teaching has consistently affirmed, is that economic life is not amoral or autonomous *per se*. Business and economic institutions, including markets themselves, must be marked by internal relations of solidarity and trust. This means that profit, while a necessary means in economic life, cannot be the exclusive end for truly human economic flourishing. Instead, as Pope Benedict points out, the social enterprise, that is, business efforts, must transcend the dichotomy of for-profit and not-for-profit, and pursue social ends while covering costs and providing for investment.<sup>13</sup> More broadly, the Holy Father is urging business educators and practitioners to re-think who must be included among corporate stakeholders and what the moral significance of investment is.<sup>14</sup> *Caritas in Veritate* is not an economic policy paper with the primary intention of advocating any particular institutional program. In fact, the Pope goes to great lengths to stress from the beginning that its central concern is not economic development *per se*, but 'integral human development', or the understanding of true human progress as a 'vocation'. For Benedict, a proper understanding of the challenges to our moral development requires further and deeper reflection on the economy and its goals, to be sure, but this is only a first step towards bringing about a 'profound cultural renewal' that cannot fully be captured by the technical language or categories of academic economics.<sup>15</sup>

### The Centrality of the Human Person, *the Continuity of Catholic Social Doctrine*

For Pope Benedict, the phenomenon of globalization, with its positive and negative consequences, is not the result of blind and impersonal histor-

<sup>12</sup> Cfr. *Caritas in Veritate*, n. 21.

<sup>13</sup> Cfr. *ibid.*, n. 21.

<sup>14</sup> Cfr. *ibid.*, n. 40.

<sup>15</sup> Cfr. *ibid.*, nos. 8,9.

ical forces, but rather the organic outgrowth of our deep longing for spiritual unity.<sup>16</sup> While the family, and by extension the local community, are the most natural stages for moral flourishing, we are ‘constitutionally oriented towards “being more”’,<sup>17</sup> always striving to further approximate the image of God in which we are made. This basic inclination towards transcendence expresses itself in the technological inventiveness of our freedom as well as is evidenced by our ceaseless attempts to conquer and control the forces of nature by our own efforts. And yet, as the Holy Father points out, the ‘cultural and moral crisis of man’, which comes about by ‘idealizing’ either economic or technological progress as the ultimate human goals, leads to a detachment of these goals from moral evaluation and responsibility. Both of these idealizations produce the intoxicating sensation of our own self-sufficient ‘autonom’, and a misguided notion of ‘absolute freedom’. Our gravitational pull towards ‘being more’ should never be confused with the possibility of ‘being *anything*’ or having everything.

Catholic reflection upon what it means to be authentically human in history and culture goes back to the Fathers of the Church in the second and third centuries. Throughout the course of history, the Church has never failed, in the words of Pope Leo XIII, to speak ‘the words that are hers’ with regard to questions concerning life in society. The proclamation of Jesus Christ, the ‘Good News’ of salvation, love, justice and peace, is not readily received in today’s world, which is devastated by wars, poverty and injustices. For this very reason, people everywhere have a greater need than ever of the Gospel: of the faith that saves, the hope that enlightens, of the charity that loves.<sup>18</sup> When the Bishops of Africa gathered in synod last October, they expressed the same need of their continent for Christ, saying: ‘We are therefore committed to pursuing vigorously the proclamation of the Gospel to the people of Africa, for “life in Christ is the first and principal factor of development”, as Pope Benedict XVI says in *Caritas in Veritate* (CV, 8). For a commitment to development comes from a change of heart, and a change of heart comes from conversion to the Gospel’.<sup>19</sup>

<sup>16</sup> Cfr. *ibid.*, n. 42.

<sup>17</sup> Cfr. *ibid.*, n. 18.

<sup>18</sup> Cfr. Pontifical Council for Justice and Peace, *Compendium of the Social Doctrine of the Church* (2004), xx-xxv.

<sup>19</sup> *Message to the People of God on the occasion of the Second Special Assembly for Africa of the Synod of Bishops* (October 23, 2009) n. 15.

It has often been said that the Church is an *expert* in humanity, and the Church's expertise is rooted in its active engagement in human affairs, ceaselessly looking towards the 'new heavens' and the 'new earth' (2 *Peter* 3:13), which she indicates to every person, in order to help people live their lives in the dimension of authentic meaning. *Gloria Dei vivens homo: The glory of God is man and woman alive!* This sentiment is the reason why the Church teaches, not only Catholics but people of good will everywhere, about the things that truly matter in life. 'Testimony to Christ's charity, through works of justice, peace and development, is part and parcel of *evangelization*, because Jesus Christ, who loves us, is concerned with the whole person. These important teachings form the basis for the missionary aspect of the Church's social doctrine, which is an essential element of evangelization. The Church's social doctrine proclaims and bears witness to faith. It is an instrument and an indispensable setting for formation in faith'.<sup>20</sup> In the context of faith, the social doctrine of the Church is an instrument of evangelization, because it places the human person and society in relationship with the light of the Gospel of Jesus Christ.<sup>21</sup> In short, Catholic social doctrine offers a sound approach to thinking about economic and financial realities based on fundamental moral and spiritual principles that speak to the truth of the human person and the centrality of the human family in world affairs.<sup>22</sup>

#### *The Concept of Moral Responsibility and the Need for Solidarity:*

Preferential love for the poor is part of the most basic Christian tradition, dating from the practice and teaching of Christ ('*As you did to one of the least of these my brethren, you did it to me*') [*Mt* 25:40].<sup>23</sup> This has been the central thread of the Christian tradition throughout history, expressed visibly by charitable works and defence of the poor. It was pursued in the institution of the *Jubilee Year* in the Old Testament, '*so that there may be no poor one in your midst*' (*Dt* 15:1-11; cfr. too, *Lev* 25); and it was the exemplary life of the early Christians, so that '*no one was in need*' (*Acts* 4:32-37).

But going beyond this duty of helping the poor, the principle of solidarity reflects the broader conviction that the human person is necessarily a

<sup>20</sup> *Caritas in Veritate*, n. 15.

<sup>21</sup> *Ibid.* See also, nos. 63 and 64.

<sup>22</sup> Cfr. *Compendium*, xx-xxv.

<sup>23</sup> Cfr. *Caritas in Veritate*, n. 27.

social being: what Africans would express as '*sumus ergo sum*'. Human society does not exist by accident or by a chance coming together.<sup>24</sup> This conviction is at the heart of the many questions which the Church raises about economic activity, and in particular in relation to the development of the financial sector and the just distribution of power and wealth.<sup>25</sup> In this respect, and in the light of our discussions in these days, it seems to me that there are several related questions that will require ongoing reflection: (1) the excessive concentration of power; (2) the inequality between countries; (3) the distribution of economic resources which conflicts with the wider requirements of the universal destination of earthly goods; and (4) the use of resources by those who control them which does not take sufficient account of the need for social justice:

(1) Pius XI was the first to set out a critical interpretation concerning the concentration of economic power. Listen to what he wrote 79 years ago to those engaged in the financial sector: 'In the first place, 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'.<sup>26</sup> He went on to write that, 'This power becomes particularly irresistible when exercised by those who, because they hold and control money, are able also to govern credit and determine its allotment, for that reason supplying, so to speak, the lifeblood to the entire economic body, and grasping, as it were, in their hands the very soul of production, so that no one dare breathe against their will'.<sup>27</sup> While the style of the language may be rather dated, it remains true that the Church is asking a universal question concerning the concentration of power associated with financial development which stems from its understanding of human solidarity; and can we not hear a powerful echo here from the African synod, where its *Message* made the appeal: 'To the great powers of the world, we plead: treat Africa with respect and dignity. Africa has been calling for a change in the world economic order, with unjust structures piled heavily against her. Recent turmoil in the financial world shows the need for a radical change

<sup>24</sup> Cfr. *ibid.*, n. 38.

<sup>25</sup> Cfr. *ibid.*, n. 24.

<sup>26</sup> Pius XI, Encyclical Letter *Quadragesimo Anno* (1931), n. 105.

<sup>27</sup> *Ibid.*, n. 106.

of rules. But it would be a tragedy if adjustments are made only in the interest of the rich and again at the expense of the poor'.<sup>28</sup>

(2) Inequalities among countries must also be addressed squarely in light of the need for solidarity in this context. In order to be just, the interdependence between countries should give rise to new and broader expressions of solidarity which respect the equal dignity of all peoples, rather than lead to domination by the strongest, to national egoism, to inequalities and injustices. The monetary and financial issue therefore commands attention today in an urgent and new way.<sup>29</sup>

(3) The Church holds that there is a universal destination of earthly goods, whereby the earth's resources are provided for the use of all human beings, so that their right to life can be respected in a way that provides for both the dignity of the individual and for the needs of family life. This principle, however, raises certain problems for the economist. In a market economy, financial intermediation has a major role in the allocation of resources. The savings of some are used to finance the investment needs of others, in the hope that the proper functioning of this financial circuit will play its part in attaining an optimal economic growth. A serious question lies at the heart of this financial strategy: Does this process lead towards the effective implementation of the universal destination of earthly goods? The answer to this question is not easy to discern, but it must nevertheless be pondered, and often, when investment decisions are being made.<sup>30</sup>

(4) This leads to the fourth consideration in the context of the need for solidarity. Since financial activity can involve important risks, it can lead to very large profits for both individuals and companies. In this context, the Church has usually restricted itself to pointing out in general terms some basic principles to be followed and the need for each individual to exercise his or her discernment. Yet, the individual must never lose sight of the fact that even those resources he possesses belong not only to him but also to the wider community. They should be used not only for his profit, but also for that of others.<sup>31</sup>

The enterprise of business education and business practice must always be understood in conjunction with our moral responsibility, rooted in a

<sup>28</sup> *Message to the People of God on the occasion of the Second Special Assembly for Africa of the Synod of Bishops* (October 23, 2009) n. 32.

<sup>29</sup> Cfr. *Caritas in Veritate*, n. 43.

<sup>30</sup> Cfr. *ibid.*, n. 42.

<sup>31</sup> Cfr. Second Vatican Council, *Gaudium et Spes*, n. 69.

recognition of that which limits us. In this regard, effective governance and aid which provides support for development are needed in charting a path towards more integral development. The challenge to 'humanize' or 'civilize' globalization through the mechanism of business education and practice does not necessarily mean more government. It does, however, demand *better* government – the rule of law, the development of strong institutions of governance, the restoration of the balance between competing interests, the eradication of corruption. *Caritas in Veritate* properly recognizes that States are not to relinquish their duty to pursue justice and the common good in the global economic order, but also that subsidiarity and solidarity must be held in tandem. Ethical business practice demands fairer and freer trade, and assisting the poor of the world to successfully integrate into a flourishing global economy.

As we have discussed in this Conference, Pope Benedict is not so much concerned with globalization as an economic phenomenon, but rather the 'underlying anthropological and ethical spirit' of the economic order, of globalization, of the business world, and their 'theological dimensions'.<sup>32</sup> Indeed, this is what the Pope seems to mean when he contends that 'every economic decision has a moral consequence'.<sup>33</sup> The question of business, therefore, becomes a social and radically anthropological one: When it comes to business, we are called to respect not only profit, but the moral conditions of those who pursue it. If we engage in this effort, recognizing our call to do the truth in love, we will authentically continue to respond to the great commission to 'make disciples of all the nations'.

#### SOME STRIKING FEATURES<sup>34</sup> OF *CARITAS IN VERITATE*

The effort, as observed above, to address *social, global, economic, financial, entrepreneurial, political, anthropological and ecological* issues as they impact on the human person and his total and integral development is certainly a striking feature of *Caritas in Veritate*. The challenging task of presenting a synthetic vision of all the problems of human society, full of ten-

<sup>32</sup> *Caritas in Veritate*, n. 42.

<sup>33</sup> *Ibid.*, n. 37.

<sup>34</sup> Fr. Gianpaolo Salvini S.J. prefers to describe these striking features of the encyclical as *Le novità dell'enciclica* ['L'Enciclica *Caritas in Veritate*', in *La Civiltà Cattolica*, (#3822, 19 Sept. 2009), 469-470], and the ideas expressed here are taken from him.

sions, contradictions, pitfalls, but also with positive signs of hope, in the light of faith and in the light of natural ethics and reason is certainly new.

It is equally striking how *benignly* and *pastorally sympathetic* the encyclical treats even those issues which are considered problematic, unethical and unfavourable to humanity's growth and development. There is no demonization of *economics, market, technology, globalization, trade* and *other economic activities* etc.: the structures and activities of man and society which impact negatively on the dignity and vocation to development of the person. There is rather a commendation for development, entrepreneurship, market, technology etc., as expressions of the human spirit and *per se* not evil. It is their abuse in the hands of sinful humanity against humanity's good that the encyclical cautions against.

It is also noteworthy how the encyclical enriches the deposit of the Social Teaching of the Church with a series of notions and realities, hitherto unknown in the Magisterium of the Church, such as, notions about *finance, voluntarism, ethics in economics (economia etica), reasonable use of natural resources, responsible procreation, gratuitousness* and the *logic of gift in economics* (where until now the overriding concern has been *profit-making*), etc. These are ideas which are gaining currency in discussions among economists, believers and non-believers alike. The encyclical also invites the State and Politics to promote economic freedom and imitative, and not to suppress them. It calls for the recognition of the role of *intermediate bodies* and *groups*, guided by a principle of *fiscal subsidiarity*, to give voice to people in the determination of the life and conduct of the economy.

Another discernible thrust of the encyclical is the *evangelization of reason* and of *social, economic, financial, political and technological structures* with a view to making them more human and open to transcendence. The appeal to the reality of the *brotherhood* of the human family, and the consequent sense of *solidarity* and *reciprocity* aims at restoring hope to humanity's sense of being a family.

## CONCLUSION

In the final analysis, it is fundamentally the issue of the ultimate goals of humanity which should underline the concern of governments, non-governmental organizations, and individuals alike. Faced with the choices involved in finance and in economics at every level, there can be no purely financial and economic response. We must look higher!

If, in the end, our goal is to reach ‘the integral development of man and of all men’, according to Popes Paul VI, John Paul II, and now Benedict XVI, the response to these challenges from a Christian standpoint must go beyond the simple question of management, however efficient this may be. Since social relations also have a spiritual dimension, the true response must be both moral and spiritual. It must pass through a conversion implying renewed fidelity to the Gospel and an unshakeable determination to do nothing which could undermine the divine calling of humanity.

At the end of the day, the encyclical *Caritas in Veritate* calls all and sundry to the development of a serious sense of *moral responsibility* for humanity, for its world, for its integrity (anthropology) and for its vocation. Such a sense of responsibility can be developed only in the experience of *love*, which comes from God and is destined to be the nature and attribute of us all. Either as the nature and attribute of God or as an endowment of the human person, love is true to its nature only when it is *free*. Only a free being can love; and it is *truth* which makes one free. ‘*The truth shall make you free*’ (Jn 8:32). Thus, ultimately, it is only in *truth* that one can *love*!

Thank you for your kind attention.

SCIENTIFIC PAPERS

WHERE DO WE STAND? THE IMPACT OF THE CRISIS  
ON PERSONS AND INSTITUTIONS

## GENERAL OVERVIEW OF THE MAGNITUDE OF THE CRISIS. THE GLOBAL COMPONENTS\*

JOSÉ T. RAGA

The rich world and the poor world, west and east, in essence the economic universe at the beginning of the 21st century, has been hit by a crisis for which it was not prepared. Its intensity and extent, as well as the speed of transmission of its effects, has surprised humanity, and even those who had been alerted of worrying symptoms in the area of economic activity, because the daily warnings of the markets – and the economic scenario in general – did not serve to restrain the foreseen event, the extent of which has been more accurately assessed *ex post*, than it could have been based on the *ex ante* opinions. Perhaps the change of framework in economic relations at the beginning of this century converted a common phenomenon into a hitherto unknown event.

It is true that crises are not exceptional events in the history of humanity and certainly not in the economic history of the same. After all, we are all aware that economic activity unfolds with peaks and troughs, far from the much sought after stability that we preach as the utopian objective of any economic system. These changes – economic cycles – regardless of their brusqueness, are the general rule and not the exception to economic evolution in all nations and in all national economies. This being so, in

\* I am very grateful to Prof. Jörg Guido Hülsmann (University of Angers – France) for his outstanding detailed written comment to an earlier version of this paper; gratefulness I want to extend to Prof. Stefano Zamagni (University of Bologna – Italy), Prof. Vittorio Hösle (University of Notre Dame – USA), Prof. Partha S. Dasgupta (University of Cambridge – UK), Prof. Juan J. Llach (Austral University – Pilar, Argentina) and Prof. Michael Novak (American Enterprise Institute – USA), for their most helpful discussions and ideas, favouring the improvement of this contribution. Of course, any responsibility for errors and misunderstandings is exclusively the author's.

principle, economic crises should not be unduly dramatized, since economic crises as such are no more than one stage of the four phases into which an economic cycle is divided.

The attention to be given to the study of a particular crisis is determined by its intensity or seriousness, whether due to its profound effect on a community, or even a sector or economic activity, or because its effects extend, with even greater intensity, to a wider community, encompassing entire regions or even the world economy. In this sense, the crisis – if one were to position it in time, without attempting to identify its origin, one would have to opt for the final quarter of 2007, when its existence could no longer be ignored –, takes place in a new economic scenario that did not exist in other, even recent, times.

#### GLOBALISATION AND INTERDEPENDENCE

The scenario to which we refer is none other than that which we ourselves have designed as a global world of economic relations – perhaps not just economic –, of permeability of markets, cross-border fluidity and agility in the exchange of goods, services and financial resources – human resources are still far from the global model –, essentially a world and markets that are open and without frontiers. This statement does not impede acknowledgement of the culpability of the rich countries, designers of the model, in the numerous restrictions that still exist, encouraging discriminatory protectionism in the developed world, with the most detrimental effects being felt in the poorest countries.

H.H. Benedict XVI reminds us of this in the following terms: ‘... in the economic sphere, the principal form of assistance needed by developing countries is that of allowing and encouraging the gradual penetration of their products into international markets, thus making it possible for these countries to participate fully in international economic life ... there are those who fear the effects of competition through the importation of products – normally agricultural products – from economically poor countries. Nevertheless, it should be remembered that for such countries, the possibility of marketing their products is very often what guarantees their survival in both the short and long term’.<sup>1</sup>

<sup>1</sup> Benedict XVI, Encyclical letter *Caritas in veritate*, Rome 29.06.2009, n. 58.

It is certainly the case that the phenomenon of globalisation is another step in the historic aspiration of a humanity in search of markets; in some cases goods markets and, in not a few cases, the attempt to find new sources of supply in the resources markets. Through this broadening of economic influence, there is also evidence in historiographic studies of the influence also of cultures, habits, and procedures, which have gradually been assimilated in human and community development itself. By way of example, let us think of the legacy left by the Phoenicians in the culture of Mediterranean countries, or the cultural flow arising from the silk routes and the spice routes – between east and west – or the no less profound cultural flow of the routes with the New World.

Without entering into the details that differentiate some events from others, it is true that all have a common denominator: the desire to find a broader economic horizon. And, in this sense, globalisation is nothing other than the materialisation of this incessant search, in this case, at the end of the 20th century and the beginning of the 21st. Man has always used the most appropriate means and techniques at his disposal to successfully negotiate the path to the desired objective. Examples include: the boat to sail to his destination; recently invented cartography to guide the convoy from origin to destination; later came the steam engine and later still the internal combustion engine or turbine, bridging geographic distances to facilitate a market which would see a reduction in transportation costs for tangible goods, thereby turning geographically distant markets into nearby ones.

Globalisation has also enjoyed a new tool, unavailable to markets in the past. We refer to new information and communication technologies (ICT). Thanks to the development of ICT, the development of semi-conductors, fibre optics, broadband, etc., in the century which started a mere ten years ago, the most remote markets imaginable are known and operated in and decisions can be taken in real time. Both triangular and multilateral transactions are possible and perfectly set up instantaneously by agents whose place of residence is of no importance, affecting, for better or for worse, national economies which, in the absence of protective barriers, become mere atoms in a complex global world.

Therefore, in the current crisis, two initial characteristics can be appreciated, characteristics of an accidental nature if one likes, characteristics which I would like to highlight: on the one hand, the uniformity or, if one prefers, the homogeneity of trends in economic development, despite the extreme diversity of the different countries; on the other hand, the unusual speed, one might almost speak of immediacy, in the production of effects,

despite that diversity. A good example of this point can be seen in Figure 1 (p. 597), in which the interdependence is clearly visible in the great similarity of the curves representing the evolution of gross domestic product in the different national economies. John Paul II had warned of this '... in a world divided and beset by every type of conflict, the conviction is growing of a radical interdependence and consequently of the need for a solidarity which will take up interdependence and transfer it to the moral plane. Today perhaps more than in the past, people are realizing that they are linked together by a common destiny, which is to be constructed together, if catastrophe for all is to be avoided'.<sup>2</sup>

We have chosen seven countries that are very significant in terms of their economic importance, whilst also quite different as regards their economic and political structure. The coincidence in the timing of trends in the cycle occurs with the greatest exactitude – in my opinion as a consequence of the interdependence of the global model –, this being the moment to remember that, in contrast to the current situation, the Great Crisis of 1929-1930, which began in autumn of 1929 in the United States, did not make its presence felt in Europe until the spring of 1930. Another matter is the intensity of the effects, more related to economic, political and institutional structure, which is of very diverse efficacy in the countries analysed. Therefore, the graph clearly shows something that we have mentioned before, that the evolution of the economies is far from stable, with evidence of permanent imbalances that oblige those responsible for economic policy – governments and institutions – to resort to the game of stabilizers, with very differing degrees of success from one country to another.

In Figure 2 (p. 597), we can see the different incidence of the crisis and also the different efficacy of these anti-cyclical measures in the countries considered. On looking at 2009, a year of negative growth rates for all the countries, we can observe a great disparity in the figures, with a curve that goes from (-2.3 %) France to (-5.3 %) Japan. It is significant however that the 2010 recovery forecast for the two economies inverts the order of their magnitude, with the Japanese economy moving into positive growth of (1.7 %), while the figure for the French economy is just (1.4 %). The situation for Spain is different. Though the 2009 contraction was lower (-3.6 %), it will continue in the recessive stage of the cycle in 2010 with a growth rate of (-0.6 %) – some forecasts put it as low as (-1.0 %) –, and will have to wait until 2010 for a possible recovery with a positive rate of (0.9 %).

<sup>2</sup> John Paul II, Encyclical letter *Sollicitudo rei socialis*, Rome 30.12.1987, n. 26.

There are diverse reasons for this disparity of effects of the measures each national economy establishes to tackle the crisis and initiate the recovery phase. As we have already mentioned, of significant importance in this analysis is the economic structure itself and the strength of the institutions of each nation. But of no less importance is the strength of governments when it comes to making decisions that might be unpopular and above all, the priority given by these governments to efficiency as opposed to the sustenance of a demagogic ideology, bereft of realism in terms of the dealing with the problem.

In the light of all this, what remains on the table for detailed analysis are the effects which might be expected of measures applied uniformly to economies which have little in common. We refer to the economic policy decisions for general application to a region – the European Union, for instance – which is framed in a scenario of inequality. Or what amounts to the same thing, that the problem can be approached in terms of whether it is possible to have a partial loss of economic sovereignty whilst, at the same time, maintaining the integrity of political sovereignty. There have been frequent conflicts in the area of the monetary policy of the European Union when a given measure – the raising of interest rates, for example – might help to reduce inflationary tensions in countries suffering this problem, whilst damaging investment and the growth rates of countries with price stability and in a position to grow.

Every country and every economy is different from others. In addition, every community is different in terms of values, customs, preferences, objectives, resources, attitudes and capacities. Therefore, also different will be the economic and social effects of any economic turbulence that might occur in each community, just as the instruments and political decisions put in place to deal with such turbulence must of necessity be very different depending on the community. That said, it is impossible to ignore that the interdependence, to which we have already referred, will condition the results of such measures in the country in which they are applied, whilst at the same time influencing the results of those implemented in countries of the environment, an environment we envisage as global.

#### THE BEGINNING OF THE CRISIS: THE REAL SECTOR

I believe that it is not incorrect to say that the current crisis began in the real sector of the economy – the production of goods and services –, although, once the crisis had begun, the financial sector was to play an

important role in its evolution. Furthermore, the real magnitudes we are dealing with enable us to state that the remote cause is to be found in the productive structure itself as can be deduced from the total productivity data which, in index numbers referring to the European Union average for the 27, are featured in Figure 3 (p. 598).

Except in the case of the United States, and to a much lesser extent France, and for very different reasons Spain, all the countries considered show decreasing productivity since 2005 and many of them since 2002. Japan could be excluded from this diagnosis since, from the year 2005, its evolution has been practically flat and furthermore at the lowest level of all countries considered, being quantitatively similar to the average for the European Union. Spain's case is exceptional, not due to productivity gains resulting from the technological enhancement of the production processes, but rather owing to the elimination of the least productive labour input, in processes maintained without improvement to capital equipment, thereby increasing the volume and rate of unemployment.

It is clear that the evolution of the productivity indexes, an indication of the strength or weakness of the productive sector, exerts consequences on the progress of the productive economy and, therefore, on the economy of the nation. More so when the agents of the real productive sector seem to assume the decline in their efficiency as a situation without remedy or, if one prefers, they do not find the incentive to provide a remedy or they cannot envisage market conditions that might enable them to contemplate a more favourable scenario.

From here, it is not far to the logical outcome. The proof of this is to be found in the contraction in the growth rates of the industrial production indexes that feature in Figure 4 (p. 598), with 2005 as the base year. Despite being positive for 2006, the growth is extraordinarily weak in practically all the countries considered, with indices of (1.1) for France and Greece, (1.7) for the United Kingdom, and (2.5) and (2.9) for the United States and Portugal respectively. Germany stands out on the positive side with an index of (5.6), this being most probably a consequence of the productivity growth in this country from 2002 until 2005. To this growth in productivity, one must naturally add the exportation capacity of its industrial production, with high added value as regards its technological component.

This weakness in the industrial manufacturing sector was covered up by the strength of the building sector, which operates with unskilled labour and low salaries. Because it concealed the weakness of the industrial sector, the latter did not reach a point where it transmitted lack of confidence

or insecurity to the consumption economies. The demand for domestic and foreign goods continued to grow, creating real problems in the current account of the balance of payments, which would require abundant resources for its financing. Although it is true that domestic demand stimulates domestic production, it is no less true that a large part of this demand is aimed at foreign goods, thereby damaging the balance of goods and services of the nation.

As we see from the data in Figure 5 (p. 599), only Germany and Japan are free of deficit with the foreign sector in goods and services. The other countries considered, amongst which Spain occupies a predominant position, face a very high current account deficit, which will have serious effects on their economies. The deficit is lower in France, but in Spain, as we mentioned, it is as high as 10% of gross domestic product, the highest of the developed countries. There is an additional consideration that corroborates the distance between the optimism of the demanders and the real status of the national economy; this deficit of 10% was reached in 2007, when the economic crisis was already visibly present and inexplicably, it stayed at 9.6% in 2008, when the process of economic adjustment should have begun at least three years previously.

The year 2008 was a time in which the ingredients of the crisis, whose magnitude in terms of extension and intensity has already been quantified, became mixed with economic policy measures of a Keynesian nature. Such measures tended towards maintaining the aggregate demand of the economies and sustaining the financial sector as the intermediary in the financing of economic activity: we shall go on to observe its difficulties. This occurred to the extent that at a time of crisis caused by an oversupply in the real sector, the stimulants to demand gave rise to price tensions, as can be seen in Figure 6 (p. 599), with prices in Spain increasing by 4.1% in 2008, and in the other countries considered by over 3%. The exception is Germany, where prices increased by 2.8 %.

Along with industrial manufacturing production, we consider in the real sector, production in the construction industry. The latter, for better or for worse, has qualities that distinguish it from the former, qualities which give it a profile in its behaviour which, while not being independent from the rest of the real sector, does have a certain autonomy within it. I refer to the phenomenon of localisation.

Construction takes place in a place and at a given time; in addition to the temporal factor present in all economic activities, the peculiarity which separates it from the other activities is the spatial factor. I am not saying that

space is of no importance in the localisation of other economic activities, but rather that in these other activities, space is a variable, with its different possibilities, that is taken into account to reach an economically rational and efficient decision. Ultimately, the decision, in synthesis, contemplates the greater or lesser cost effectiveness of transporting raw materials from their origin to the place of transformation, or transporting finished good from the production plant to the place in which the demander is located.

In contrast, in the construction sector, space is not merely an alternative in models or decisions. Space is a restrictive variable which depends on the place in which it is supposed that the demander wishes to situate himself, be it permanently (permanent residence) or temporarily, even sporadically (second homes in the broadest sense). In other words, construction, in its physical aspect, is neither exported nor imported. Therefore, as a finished product, it does not compete in cross-border markets, a competition which does exist however in productive resources for construction, whether these be originating products – with the exception of land – or derivative or intermediate products to be included as such in the final product in their diverse forms.

This is why I have highlighted the autonomous, almost independent character of the construction industry in terms of behaviour, to such a degree that oversupply cannot be counterbalanced by timely exports. Nor can unsatisfied demand be met by importing from foreign markets. There is, therefore, nothing strange in the very erratic behaviour of the construction industry in the different countries considered, which is contemplated over a seven-year period in Figure 7 (p. 600).

In the first years of analysis (2003-2005), when the crisis had not yet made itself felt, the positive growth rates in the construction sector of some countries contrasts with negative rates for other countries, indicating that in the latter, the process of adjustment to eliminate oversupply in finished construction had begun. Compare the negative rates of Germany, Greece, Portugal and, to a lesser degree, France, with the positive rates for Italy, the United Kingdom, and to a greater extent, Spain.

The amounts of the indexes, both positive and negative, are also surprising in some cases. Such high positive and negative rates, frequently in excess of 10% and in some cases 30%, would, in themselves, seem to be almost inconceivable in the real sector. Let us remember that in the data previously presented for industrial production, the growth rates did not exceed 10% in any case, with the exception of Germany in 2007 and 2008, and most frequently ranged from 1% to 5%. Therefore, the presence of such

high positive and negative rates suggests that the adjustments occurred late and that, where the rates are due to oversupply, there is a requirement for the permissiveness of the financial sector in the provision of resources capable of satisfying the financing needs produced by such oversupply.

Easy financing, as can be seen from the data of housing loans granted, is presented in Figure 8 (p. 600). As opposed to Germany and Japan, with very low growth rates – less than 2%, both positive and negative –, there are others with incomprehensibly high rates; naturally those countries which now have to face the greatest difficulties. Examples include countries such as Greece and Spain, with annual growth of over 20% – Greece with growth of even more than 30% – and to a lesser extent Italy, with rates of just under that 20% mark.

There have been several reasons for this expansion in construction and the consequent increase in household debt arising from house purchase. Firstly, there is the objective of upsizing on the part of developers, leading to the accumulation of land assets in the expectation of higher profits. Then there is the concomitant interest of the public sector, both the State and local Councils; the former due to the favourable effect – a very high income multiplying effect in the construction sector – in the growth of gross domestic product, which politically translates into the success of government management, thereby guaranteeing future elections. The councils are interested in the development of the building sector due to the boost to the public coffers arising from this, both in terms of permits for development and taxes paid on property ownership and on the transmission of same.

Along with these two reasons, there is a third factor of a sociological nature. We refer to the preference for home ownership over house rental as a mark of family security and, in the Mediterranean countries, as a way of ensuring the maintenance of the value of family assets, at least in monetary terms. Since the Second World War, the experience of the market value of a home, in monetary terms, has been one of permanent growth. Therefore, families have always witnessed an increase in value and never depreciation. This has further accentuated the very generalised feeling of lack of fear of the debt entered into. This feeling is clearly perceptible from the time of the constitution or implementation of the Euro as the single currency of the European Monetary Union. Families see the Euro as something that eliminates risks that were present in the past. The Euro is the expression of a Union that makes us stronger and one in which risk is distributed over a powerful economic community that is extensive in terms of population volume.

No less important is the loss of spiritual values in society. The generalised triumph of materialism means that objects of a physical nature, material objects that can be measured and weighed, objects that can be expressed in monetary terms, have gone on to occupy the most important place in the consideration of people. It was said by John Paul II that: 'The economy in fact is only one aspect and one dimension of the whole of human activity. If economic life is absolutized, if the production and consumption of goods become the centre of social life and society's only value, not subject to any other value, the reason is to be found not so much in the economic system itself as in the fact that the entire socio-cultural system, by ignoring the ethical and religious dimension, has been weakened, and ends by limiting itself to the production of goods and services alone'.<sup>3</sup>

So much so, that we frequently find individuals and families distressed by the terms of a debt produced for purely hedonistic reasons – to finance pleasure trips, for example – or for materialistic reasons – attempting to present a public image of wealth, the possession of cars, properties, second homes for leisure, etc. – which oblige those entering into such debt and their families to shun goods of a spiritual or immaterial order that permit the growth of the 'being', though this might relegate to a secondary place the importance of the 'having'.

Along with all these reasons, it is necessary to add the final and perhaps most significant factor, the cost of money. Low interest rates, and even lower rates for specific types of economic activity, boost the market, though it should be pointed out that they disturb it by generating a fictitious market which operates on bases that are unrelated to the real world. However, such interest rates produce, in the short and medium term, favourable effects as though the reality of the markets was guaranteed. The stimulus effect, clearly visible in the willingness of families and company to enter into debt, is unquestionable, even though such debt may be to their own detriment.

It seems elementary that if, as can be seen in Figure 9 (p. 601), interest rates in real terms – interest rates less inflation rates – reach the point of being negative, as was the case in Spain in 2005 and the United States in 2008, or if they are very low – less than 1% –, it constitutes a stimulus for indebtedness that becomes a reality if financial intermediaries fail to place obstacles or establish restrictions on the granting of loans. We have experienced a period – from 2005 to 2008 – of cheap and easy money. The Euro Zone has had to wait until 2009 to see interest rates in real terms rise to above 3%.

<sup>3</sup> John Paul II, Encyclical letter *Centesimus annus*, Rome 01.05.1991, n. 39.

The year 2009 saw the loss of the capacity to hide the crisis or at least reduce its effects through demand-side policies sustained by intervention of the public sector in significant markets such as construction, cars, etc. This led to a situation where all the employment maintained or created fictitiously by means of incentives, aid or subsidies had to face reality in 2009, when there was a dramatic increase in unemployment in all the countries considered, without exception, as can be observed in Figure 10 (p. 601). Unemployment which would deprive man of work ‘... to realize his humanity, to fulfil the calling to be a person that is his by reason of his very humanity’.<sup>4</sup> Also bearing in mind that, ‘Work constitutes a foundation for the formation of *family life*, which is a natural right and something that man is called to’.<sup>5</sup>

Once again, Spain heads the unemployment table of the countries taken into consideration and likewise occupies the same position if we consider all the countries of the European Union, with an unemployment rate of 18.1% of the labour force. The least growth in unemployment was in Germany, though it does not contradict the general trend. This would seem to confirm that in this case, anti-cyclical policies have had a very short-term and, above all, very transitory effect.

#### THE ROLE OF THE FINANCIAL SECTOR

Along with what has been said for the real sector of the economy, it must be stated, without fear of error, that we are facing a global financial crisis which has shaken the very foundations of the system and placed in doubt the very function that it is called upon to fulfil in the modern economies.

The year 2007 showed that, in addition to the urgent need to move towards the adjustment of markets for goods and services and, above all, the construction and automotive industries, excesses had taken place in the financial sector that gave rise to a general lack of liquidity and, also at times, to a lack of solvency. The sector was attracted to the search for business, for disproportional growth, often with very little economic rationality and this was facilitated by the market structure of oligopoly. This led the agents to actions that were very distant from the prudence demanded, both in the composition of the ordinary and everyday transactions of financial

<sup>4</sup> John Paul II, Encyclical letter *Laborem exercens*, Rome 14.09.1981, n. 6.

<sup>5</sup> John Paul II, Encyclical letter *Laborem exercens*, Rome 14.09.1981, n. 10.

mediation and in those operations that might be considered more sporadic and exceptional, such as the acquisition of enterprises. All this had the single objective of increasing market share.

It is appropriate to remember that, 'In the list of areas where the pernicious effects of sin are evident, the economy has been included for some time now. We have a clear proof of this at the present time. The conviction that man is self-sufficient and can successfully eliminate the evil present in history by his own action alone has led him to confuse happiness and salvation with immanent forms of material prosperity and social action. Then, the conviction that the economy must be autonomous, that it must be shielded from "influences" of a moral character, has led man to abuse the economic process in a thoroughly destructive way'.<sup>6</sup>

If we previously mentioned that household economies had lost their fear of debt and had entered into excessive debt, something similar might be said of the financial institutions. Guided by the objective of rapid growth, they have entered into excess debt, endangering their own solvency, and possibly even worse, casting doubt on confidence in the system. Confidence without which the financial system cannot survive, since confidence, due to the very nature of the system, is its cornerstone.

It might be said that the financial system lost sight of its own mission in the world economy. It must be remembered that the only objective of the financial sector in the modern economy is to serve the real economy. Let us consider that thanks to a solid and reliable financial system, the modern economy is spared the need to look to a system of bartering goods for goods in transactions, which would impose enormous restrictions on its scope. On the contrary, it has at its disposal quick and varied means of payment in accordance with the needs of each transaction. Its objective cannot be any other, therefore, than providing the market with the means of payment necessary, and only those necessary, to enable real economy transactions to take place quickly within a framework of stable prices; operating also as the link between those subjects whose excess of income over consumption makes them savers and those whose wherewithal does not allow them to invest in fixed assets and who therefore require external financing.

Each function has been replaced by very short term personal objectives – immediate and rapid growth, albeit with high risk, and apparent profit to increase the value of the institution on the stock market – not related to the

<sup>6</sup> Benedict XVI, Encyclical letter *Caritas in veritate*, Rome 29.06.2009, n. 34.

proper functioning of the financial system, sacrificing its reliability and endangering its long term survival and the confidence of clients and society in general in the institutions.

For this reason, Benedict XVI said, '*Finance*, therefore – through the renewed structures and operating methods that have to be designed after its misuse, which wreaked such havoc on the real economy – now needs to go back to being an *instrument directed towards improved wealth creation and development*. Insofar as they are instruments, the entire economy and finance ... must be used in an ethical way so as to create suitable conditions for human development and for the development of peoples ... Financiers must rediscover the genuinely ethical foundation of their activity, so as not to abuse the sophisticated instruments which can serve to betray the interests of savers. Right intention, transparency, and the search for positive results are mutually compatible and must never be detached from one another'.<sup>7</sup>

In other words, the financial sector has abandoned the primary function of serving the real economy and has become transformed into the centre of itself and into the artifice of a new world which is the product of its very activity. And it is this anxiety for power and gain which has led it to the lack of confidence without which it cannot survive. It should not be forgotten that, in contrast to the real sector, which is characterised by immediate transparency, even more so with respect to goods than services, the financial sector is a very opaque one that requires confidence as a requisite without which it cannot function [terms such as *financial, fiduciary, etc.* have a common origin in the Latin *fiducia-ae*, which means nothing other than *confidence*].

The old prudence index of the financial system, which related the resources of the financial institution – share capital plus reserves – with the volume of loans it could grant, has been passed over and replaced by what has become predominant, a *more aggressive style* of financial activity. A consequence of this greater aggression is a result whereby, in Europe, with large differences between some countries and others, the financial institutions, on average, grant loans to a value of fifteen times the value of their own resources. This indicates that at least fourteen times the value of their resources were the product of entering into debt, be it with their own clients, external credit institutions or central banks. And if we focus the

<sup>7</sup> Benedict XVI, Encyclical letter *Caritas in veritate*, Rome 29.06.2009, n. 65.

analysis on the United States, the average in that country of loans granted by investment banks is twice that of Europe, meaning that loans the equivalent of thirty times the value of own resources were granted.

A large portion of these loans were granted for the purchase of houses by households; let us remember the data shown in Figure 8 (p. 600). Therefore, they were long-term loans which were formally secured by a mortgage guarantee over the real estate property, meaning that the loan was guaranteed by the value of the residence. This being the case, and if we placed this consideration of the situation we are examining back a quarter of a century, before so-called *financial engineering*, with its instruments and excesses, gained a foothold, i.e., a period of prudence in the financial sector, there would be nothing to object to in the granting of such loans by the system.

However, the situation in 2006, a date up to which the mortgage credit had been growing constantly, though less in this year than in 2005 – a retraction which would continue in subsequent years – was very different from one which would have enabled us to ensure solvency and confidence in the financial system. Once again, the anxiety to capture market share by the institution, the profit expected of it, the bonuses to directors for success in the management of objectives set, and the personal objectives of said directors – rapid personal capitalisation and subsequent searching of the market for another better opportunity; i.e., the *quick in quick out* principle to be detected in the attitude of the mercenary – converted these credit operations, which gave the impression of being guaranteed, into high-risk loans.

A risk determined by two reasons which, when placed alongside each other, multiplied the risk. One was the lack of relationship between the loan granted and the value of the real estate securing it. In many cases, the amount of the loan was over thirty percent higher than the value of the property that guaranteed it. Therefore, in the case of failure to pay by the mortgaged debtor, the loan could not be recovered due to the shortfall in value of the mortgaged good. The other reason, to be added to the previous one, is the lack of care in the consideration of the solvency and honour of loan applicants. In these conditions, if we add the irresponsibility of the financial institutions in these two questions to the irresponsibility of loan applicants in meeting the obligations arising from taking out such loans, the result could not have been any different to what it turned out to be.

And a nuance should be added to what we have just said. We are speaking of loan applicants, with the risk of focusing our attention fundamentally on persons and households, when in these cases it has been shown that the risks defaulting are much less. The family who has settled into a mort-

gaged home, will sacrifice, and indeed is sacrificing, to the limit its family finances in order to continue having such mortgaged property at its disposal. It will deprive itself of whatever necessary in order to meet the due dates of the loan and make every effort to ensure the successful payment of same.

The problem is more complex and the solution more difficult when we consider loans granted to the property developer. The latter allowed himself to become carried away at the prospect of growing possibilities, which led him to accumulate urban land, artificially scarce in most cases due to public intervention, financed by debt from a generous financial sector. When the property-financial bubble burst, this land was either in the form of a plot that had not been built on or one that had been built on but not sold, meaning that the mortgage could not be transferred to the buyer.

The difficulties for the financial sector in these cases of company insolvency, as opposed to family insolvency, are those that have thwarted the possibilities of stability in the system. Both the concentration and amount of these risks and the prudence of the company faced by possible insolvency has turned these credit operations into the true disease of the financial sector, a disease aggravated by the sector itself through improper use of the possibilities offered by the instruments created by it.

We have already mentioned that the financial sector abandoned its mission to serve the real sector and had become the centre of itself and a conductor, through its activity, in that selfsame real economy. In that self-sufficient role of protagonist, guided by the anxiety for profit and power, and far from the prudence to be demanded of any mediator between savers and investors, given that its activity relies on resources saved by its clients and deposited in the financial institutions, some agents, despite being aware that those mortgage loans granted were high-risk – not for nothing were they given the name *sub-prime mortgages* – issued securities guaranteed by said mortgage loans without sufficient guarantees, in order to attract new savings in the market and continue growing in profit and power. In the minds of all of us, and permit us the reference with *animus docendi*, are entities and persons such as Lehman Brothers, Madoff, and many others who, knowingly or unwittingly, cooperated in placing such instruments on the market, undermining confidence in the system and damaging the economies of persons, families, and nations.

It is quite true that all these met with the connivance of government stimuli, governments who, with their objectives focused on the elections, were not as worried about the health of the financial system as they were about the outcome of the voting. A climate of euphoria in the national econ-

omy, a situation of, at least apparent, improvement of subject and of families would be the perfect scenario to guarantee election and a new term of office. Therefore, faced by the drawbacks apparent in such accelerated growth in the national economy and the evident risk of the high level of debt of the real economy – fundamentally construction – which could place doubt on the solvency of the financial system, the attitude was to look the other way, rather than to put the brakes on the excesses taking place, excesses that would ultimately undermine the very foundations of the financial activity so necessary in a modern world with constant economic and technological expansion. Once again, political interests – also identified with anxiety for power – prevailed over economic rationale and over the necessary prudence which has always governed financial activity.

#### THE SITUATION IN A GLOBALISED WORLD

In principle, the assessment of the attitudes of the financial sector would not be different if they occurred in a closed market or a market without frontiers, i.e., a global market such as that in which we move. A global market which, very specially, demonstrates its capacity in the connection and perfection of operations between suppliers and demanders of financial resources, and even more so when these relations take place between those operating in the market for goods. It is clear that a market in which the traffic of what is supplied and demanded boils down to simple annotations in account opens the maximum possibilities of speed and agility in a world without frontiers which, in addition, has at its disposal the technology to enable transactions in real time at distances unimaginable in times gone by.

It is indeed this global model, conceived to transmit action that benefits humanity, which has enabled, as never before, the transmission of the defects and vices of a humanity preoccupied with personal profit, with absolute disregard to the damage this might mean for society as a whole. The Holy Father has said that globalisation ‘... has been the principal driving force behind the emergence from underdevelopment of whole regions, and in itself it represents a great opportunity. Nevertheless, without the guidance of charity in truth, this global force could cause unprecedented damage and create new divisions within the human family’.<sup>8</sup> In this way,

<sup>8</sup> Benedict XVI, Encyclical letter *Caritas in veritate*, Rome 29.06.2009, n. 33.

making perverse use of the possibilities afforded by globalisation, it has been possible to disperse at great speed those toxic assets which, issued in a certain place by one or several specific entities, have been distributed and sold to final savers, either in isolation or as part of those baskets of securities making up the products known to us as investment funds.

In this, the necessary cooperation of the financial intermediaries was forthcoming. These intermediaries, transformed into investment consultants for their clients, did not hesitate to recommend securities for the investment of savings, when, in all probability, rigour in the carrying out of the advisory role was not the distinguishing feature of the mediation. We are convinced that, in most cases, the agents who served as mere instruments for the selling of such securities were ignorant of their solvency and consequently the risk that they were transferring to their clients, in principle, in good faith.

It is of course true that the good faith was usually accompanied by the promise, in the words of the advisor, of high yield, the appeal of which caused the saver to marginalise the guaranteed securities of large and solvent issuers or of the states themselves, which precisely due to the high level of guarantee offered less profitability in the market. Once again, the anxiety for a higher yield in the short term clouded the mind of savers, leading them to opt for an unknown risk in preference to the lower yield of a known security. Naturally, the opaqueness of these products, underlined by the general lack of transparency of the financial sector, would contribute to their sale, in a world of imperfect information and directed by interests that are not always visible. It is this imperfect information that obliges savers to rely on their confidence in the agents of the financial market, a confidence that has been undermined by these events.

But the greater yield promised was not the sole reason for the successful distribution of the toxic assets. The definition of the standardized securities portfolios, on the one hand, and the setting of objectives in their positioning on the market, would play a significant role in the operation. Underlying these objectives and supporting the design of the composition of such portfolios would be the high commissions associated with these assets for the bank and intermediary financiers in general. A commission premium, above the normal level in these markets, which should have caused preoccupation and doubt in the prudent administrator.

This minimum prudence to be demanded of those administering the funds of others, and the courts are exposing the attitudes of certain agents – recently in the USA we have the examples of the lawsuit taken by the SEC

against Goldman Sachs for defrauding its clients and the possible decision regarding the Paulson & Co. *hedge fund* – which raises suspicion that a number of them were fully aware of what was happening, of how the lie was flooding the market, defrauding those who had placed their trust in it and how only the great profits of those who had designed the junk securities had become the driving force of the financial markets.

The opaqueness of the market, which had created a climate facilitating mistakes or cheating, depending on individual cases, and the will of savers, resulting in high losses for them, also damaged the entire financial system, sowing within it doubt regarding the solvency of every entity or institution, doubt which would hinder the provision of what the market requires.

Nobody was capable of responding to the question of where those financial assets – toxic assets – were. Securities which contaminated the books of the institutions to the point of insolvency when, until that moment, they had had a semblance of respectability. So much so that, at one time, the lack of confidence amongst the oligopolists of the financial market caused the collapse, even the disappearance, of the interbanking money market, which was substituted by appeals to the central banks in the search for the resources needed to continue ordinary operations.

Thus, the financial crisis was not an abstract phenomenon. It had actors with names. There were visible culprits, though also perhaps, others who were less visible. There was no shortage of voices that made the market, and specifically the global market, responsible for the crisis. It was said that the entire situation was the consequence of excessive freedom in the financial area, in which the operators had transmitted their vices to the market until it had been destroyed.

The reality, however, could be very different. The financial market is, in all probability, the most regulated market in existence. A market in which the production of money takes place in a monopoly situation: only the central bank is authorised to issue money. The model contemplated by Adam Smith in the *Wealth of Nations*<sup>9</sup> is far removed from this and so too is Friederich von Hayek's call for the denationalisation of money.<sup>10</sup>

<sup>9</sup> Vide Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, Liberty Classics. Indianapolis 1981. Particularly Vol. I, Book II, Chapter II.

<sup>10</sup> Vide Friedrich A. von Hayek, *Denationalisation of Money: The Argument Refined*, Institute of Economic Affairs. London 1978.

But not only does the State, or the consortium of States in the case of monetary unions, hold the monopoly of the creation of money, it also exercises control over the functioning of the financial sector with the objective of controlling the other instruments that share money's function as a means of payment, with the capacity to intervene in transactions, liberating the commitments entered into. And what we have said of money extends to the securities markets, with national agencies – such as the SEC<sup>11</sup> in the United States, FSA<sup>12</sup> in United Kingdom, BAWe<sup>13</sup> in Germany, COB<sup>14</sup> in France, ASIC<sup>15</sup> in Australia, FINMA<sup>16</sup> in Switzerland or the CNMV<sup>17</sup> in Spain, and so on – whose mission is to guarantee good and comprehensive information about the securities quoted on the financial stock markets, the balance sheets of the companies and institutions whose shares are traded in the organised markets, etc.

For this reason, it is necessary to ask a question. Where were the central banks and the agencies that control the securities markets, when those securities, guaranteed by mortgages incapable in themselves of guaranteeing anything, were issued and placed on the market? Where were the central banks when the concentration of risk for the financial entities in the real estate sector occurred and when the financing of this sector took place with mortgage guarantees where the value of the mortgaged property was substantially less than the loan granted?

Far from searching for responsibilities in the market as an institution, when this is no more than an instrument, one has to look for this responsibility in the persons acting in the markets and, if these persons acted in compliance with the regulations governing financial transactions, then one has to look at the regulators lest they be regulating something that does not contribute to the greatest security and solvency in the market. '[T]he 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 rela-

<sup>11</sup> Securities Exchange Commission (SEC).

<sup>12</sup> Financial Service Authority (FSA).

<sup>13</sup> Bundesaufsichtsamt für den Westpapierhandel (BAWe).

<sup>14</sup> Commission des Opérations de Bourse (COB).

<sup>15</sup> Australian Securities & Investment Commission (ASIC).

<sup>16</sup> Swiss Financial Market Supervisory Authority (FINMA).

<sup>17</sup> Comisión Nacional del Mercado de Valores (CNMV).

tions. Admittedly, the market can be a negative force, not because it is so by nature, but because a certain ideology can make it so ... 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'.<sup>18</sup>

This being the case, assuming that the regulation is appropriate – doubtful considering that at this time there are calls for new regulations within the framework of Basel III – one would have to begin to look at those entrusted with the function of control, in order to ensure strict compliance with the rules. A rule only makes sense when it is established for good and when full compliance is guaranteed. Otherwise, it merely serves to generate a fictitious confidence amongst citizens, who will be defrauded in the case of any adverse occurrence produced by the bad faith of agents or by their ignorance or incompetence.

Along with regulators and those responsible for enforcing the regulations, two new actors have had a fundamental influence in the scenario of the financial crisis: *Rating Agencies* and *Auditors*. Their function is important in any sector or activity, but much more so in the financial sector. We have already said that this sector is characterised by the lack of transparency of its products, as well as the very limited information on these products and the entities that issue and guarantee them. Therefore, the figure of bodies or persons with the authority to attest the solvency and economic integrity, as well as the good practices, of those who operate in the financial markets is essential for the proper functioning of this market and for the confidence which it requires of savers and investors for such functioning.

Auditors ensure that the accounting balances are a true reflection of the economic state of a business and, therefore, its capacity to continue in business by means of its own resources. Rating Agencies certify the degree of solvency of financial instruments and their issuers. This is an essential function in a world in which the information on these is not available, not even to those directly involved in the financial markets, and far less to external agents who deal sporadically in it, some in search of security for their savings, along with some return, others in search of a return on investment,

<sup>18</sup> Benedict XVI, Encyclical letter *Caritas in veritate*, Rome 29.06.2009, n. 36.

taking for granted the security of such investment. This is even truer, let us not forget that we are in a global market, due to the fact that the opaque nature of securities and, in general, all derivative products, is substantially increased when the market size is greater. The larger number of actors on the global stage, and the greater number of instruments in circulation makes it impossible to have direct knowledge of their characteristics.

This difficulty of subjects in terms of knowing with certainty the *who is who* of the world of financing, and the *what is what* regarding instruments circulating in the market is supposed to be overcome, on the one hand by the Auditors and on the other hand by the Rating Agencies of which we have spoken. The necessary confidence in such experts of those who approach the market is based on their judgment which is assumed to be rigorous and certain, as a result of their deep knowledge of the areas on which they give their opinions – entities and instruments – based on in-depth information obtained directly in addition to the application of their professional experience to such information.

Both Auditors and Agencies offer their services on the market and for the market, with attributes that the market itself cannot supply to those who enter it as savers in search of an opportunity for their savings, or as intermediaries channelling instruments issued by third parties in order to configure *security funds* with which to attract the savings of their clients. Their supposedly authorised opinion has the function of overcoming the lack of information and transparency of the market, to the extent that decisions in this market are taken with the firmest consideration of the opinion of these experts.

Hence the consternation when it came to light that such opinions, offered to the public in general and the specialist agents operating in the market, were, in not a few cases, gratuitous opinions with no basis in reality, which attested to a business state and a solvency of issued instruments that was not reflected in the real situation of the financial market. These evaluations of the state of financial entities and the instruments (securities) issued by them generated confidence in the agents (intermediaries and savers) on which they based their decisions. Now that the financial crisis has unfolded, it can be seen that the faith in the opinion of those actors (Agencies and Auditors) has been truncated and undermined.

The responsibility of those actors in the generalised defrauding of those who trusted in their mission is indisputable. A responsibility that becomes greater in inverse proportion to the negligence of the opinion offered. In other words, was the opinion issued with insufficient information? Was it issued in the knowledge that it did not coincide with reality and with the

sole objective of deceiving the market and its agents for the benefit of the issuing entity? Was the deceit particularly well remunerated for the party who produced it? These and other similar questions remain on the table for analysis and, in all probability, will be elucidated by the relevant courts. The first impression, however, leads us to affirm the responsibility of these Agents of public attestation, the creators of the confidence of operators in the market, in the undermining of such confidence and in the harm arising as a consequence. Only in the case of an unsalvageable error at the time of building that opinion, having managed to collect and obtain all the information required for a rigorous judgement, subsequent to a suitably in-depth analysis of the kind that might be demanded of experienced professionals, can the responsibility be mitigated or eliminated.

It is surprising that in a world – that of the 21st century – in which reference to ethics is more prevalent on the public stage than at any time in the past, there is a proliferation of attitudes in the margin of morality and alienated from any ethical behaviour whatsoever. Benedict XVI warned that: ‘Today we hear much talk of ethics in the world of economy, finance and business. Research centres and seminars in business ethics are on the rise; the system of ethical certification is spreading throughout the developed world as part of the movement of ideas associated with the responsibilities of business towards society. Banks are proposing “ethical” accounts and investment funds. “Ethical financing” is being developed, especially through micro-credit and, more generally, micro-finance. These processes are praiseworthy and deserve much support. Their positive effects are also being felt in the less developed areas of the world. It would be advisable, however, to develop a sound criterion of discernment, since the adjective “ethical” can be abused. When the word is used generically, it can lend itself to any number of interpretations, even to the point where it includes decisions and choices contrary to justice and authentic human welfare’.<sup>19</sup>

#### IMMEDIATE CONSEQUENCES OF THE ECONOMIC-FINANCIAL CRISIS

The world we contemplated in 2008 and subsequent years is quite different to that of the first five years of the current century. The optimism of the peoples that characterised the beginning of the new century has given

<sup>19</sup> Benedict XVI, Encyclical letter *Caritas in veritate*, Rome 29.06.2009, n. 45.

way to worry, decline, an obscure horizon and, why not say so, to the frustration of objectives and, in many cases, to unbearable distress.

Persons and families suffer the crisis, both in the family environment and in the business sphere. Along with them, and this is cause for even greater worry to them, the public sector seems in many cases to be disorientated as regards an appropriate approach to tackling the crisis and its consequences, at least guaranteeing the survival of a welfare state capable of bringing serenity to the mood of the peoples, ensuring that their basic needs will be covered. The poor countries feel more marginalised than before, as they contemplate the rich countries almost exclusively preoccupied by the search for solutions to their own problems, as if hunger were not a reality today also.

In rich countries, persons and families have changed their situation radically. The hopeful indebtedness of the previous era in order to build a property legacy that would give financial stability to the family, has become a burden that for many has become unbearable, forcing them to renounce their residence and lose the savings devoted to meeting the previous mortgage repayments. In some countries there has also been the first-time experience of a loss of value in real estate, something previously unknown to those who now form the community of these countries.

Some jurisdictions, in cases of difficulty or insolvency in the meeting of mortgage payments, allow the borrower to write off the loan by surrendering the property to the mortgage creditor who considered such property to be a sufficient guarantee of the loan. In others, however, the property represents only one of the guarantees of the loan. In effect, it is a real guarantee, to which a personal guarantee is always attached until the loan has been fully paid off. This means that in such jurisdictions, surrendering the property to the creditor does not free the debtor from his obligations, but rather he is still obliged to make good the difference between the value of the property and the outstanding balance of the loan. An obligation that lasts for life, until the debtor can fully pay off the amount of the outstanding loan and corresponding interest. Hence the distress of so many families facing the new economic situation arising from the economic and financial crisis. I realise that probably a good number of families entered into large debts too lightly, debts that would be difficult for them to pay off. But it is no less true that this fact does not diminish the insecurity and anxiety of the position in which they now find themselves. A situation which generates internal violence within them, that prevents them from contemplating the human horizon with the greatness of the creature who knows himself to be a child of the Creator, created in his image and likeness and called to perfection and grace.

At the same time, those low interest rates – sometimes negative in real terms – which served to stimulate family and business debt, have been replaced by higher rates, with the threat of further increases at the moment in which inflationary tensions begin to be perceived. This generates a higher cost of credit and greater outlays for its amortization, often not taken into account previously, which adds further difficulty to the already complex situation faced by families.

In addition, the unemployment rates we saw earlier in Figure 10 (p. 601) are not simply statistical data. Behind every unemployed person lie many problems. These range from the feeling of futility at not been able to enrich society with the capabilities and talents for the good of the unemployed person to the asphyxiating doubt about when the situation of unemployment will end. These problems include lack of remuneration and, in many cases, the lack of an unemployment benefit or subsidy, which makes it impossible for the person to attend to his most pressing needs in life and, of course, distances him from the possibility of meeting payments due on mortgage loans or any other type of credit commitment.

A situation which, from a macroeconomic perspective, is felt throughout society in general when it goes through, as is the case now, a phase of economic recession that affects both the real economy – the production of goods and services – and the financial economy, in respect of the availability of resources to meet the financing needs of general economic activity. The financial economy, in an attempt to provide such resources, and in a global world such as that in which we live, did not hesitate to enter into foreign debt – seeking resources where there was excess supply –, an itinerary also followed by both the business economy and the public sector itself.

The result has been a generalised growth of foreign debt with respect to the gross domestic product of the most significant countries of the developed west, as can be seen in Figure 11 (p. 602). From 2006 to the third quarter of 2009 (the latest available data), the foreign debt of the countries considered has been growing constantly, the figure for all of them standing at over one hundred percent of GDP, with the exceptions being Japan and the United States, the latter by a very small margin. The case of the United Kingdom deserves special consideration in this sense, with a level of foreign debt of over 400% of GDP in 2008. A significant portion of that debt was entered into by financial entities and these companies had to face the first due dates in the repayment of that debt in 2009. The situation will continue in 2010, with the entities being obliged, depending on the individual cases, to sell assets to obtain liquid resources or renegotiate the debt.

## ACTIONS IN THE FACE OF THE CRISIS

Faced with such a dark panorama, the lack of confidence in the financial structures and in the entities operating in this market who have always enjoyed such confidence, the first question posed at the outset, though it endures over time, concerns what to do to prevent, insofar as possible, the damage caused by the crisis to people, families, companies and, in general, the damage to the national economy. The first thing to be aware of is that we are faced with a serious crisis, which affects the economy as a whole; we are not faced by problems in a particular economic sector or industry. Neither are we faced with the shortage of certain specific resources, as was the case in 1974 with a resource as important as oil; we are facing an economic crisis whose effects have spread throughout the world with extraordinary speed. The lack of confidence, above all in the financial sector, has contaminated, with or without good reason, the global scenario in which we move.

We have preached economic freedom, though we are conscious that we do not live in such freedom and, in many cases, we avail ourselves of the exclusive benefits afforded us by such lack of freedom, though it might be to the detriment of others. Protectionism is not an exceptional practice in today's world, despite the political speeches and the proposals of international organisations – the World Trade Organisation, for example – which constantly espouse an end to restrictive practices in markets. Although, with a certain phariseeism, we might proclaim the contrary, the reality is that we feel good when we are protected by practices which, in theory, we reject. Therefore, in the present situation, it is not surprising that, faced with the question of what to do to tackle the crisis, inertia leads us to look to the public sector in search of a solution or, at least, in search of help.

The banking and business difficulties in general, and those of the persons and families of each nation, expect to be attended to and alleviated by a public sector which is not free of responsibility. And it is not free of blame because it had the task of regulating and perhaps did not do so properly and sufficiently or, if it did so, it did not control compliance with the regulation. But it was the public sector's regulating activity, whether good or bad, which deposited confidence in the economic agents to move quickly in the financial area, from which it received the message of fraud in its initiatives. In addition, in one form or another, the public sector of practically all the developed countries, and particularly European countries, has in place a welfare state which should go into operation automatically to act as an anti-cyclical stabiliser to attend to the needs of the population which appear at times of economic difficulty.

Hence, looking to the State is not quite so extravagant as might be believed. The problem is that the State is not without difficulties either. On the one hand, in times of economic crisis, when gross domestic product contracts it brings with it a reduction in the taxation revenue for the State. In parallel with the reduction in public revenue, in periods of recession, the public sector also faces higher expenditure arising from the commitments acquired by the welfare state: unemployment benefits and subsidies and, in not a few cases, an increase in early retirement.

In addition to these common obligations of the welfare structure itself, to which the subjects have contributed through taxes and specific contributions, the public sector is forced, because there was confidence in it and in its regulatory capacity, to attend to the needs of those entities facing particular difficulties, especially when their weakness might result in further damage to the rest of the economic system; a paradigmatic case is that of the financial entities, which the public sector has been inclined to help with loans, with appeals to the central bank, in order to avoid the collapse resulting from a generalised bankruptcy of the system.

This has created the need for additional resources in the public sector which, faced with the insufficiency of ordinary revenue in the budget, has had to assume situations of public deficit, over and above what would be prudent and, in the case of the European Union, above the limits set out in the Stability and Growth Pact, i.e., more than three percent of GDP. In the light of the generalized deficit, also in periods of economic bonanza, as can be seen from Figure 12 (p. 602), we cannot but remind ourselves of the advice given by Adam Smith: 'In those times of violence and disorder, besides, it was convenient to have a hoard of money at hand, that in case they should be driven from their own home, they might have something of known value to carry with them to some place of safety ...

The same disposition to save and to hoard prevailed in the sovereign, as well as in the subjects. Among nations to whom commerce and manufactures are little known, the sovereign ... is in a situation which naturally disposes him to the parsimony requisite for accumulation. In that situation the expense even of a sovereign can not be directed by that vanity which delights in the gaudy finery of a court. The ignorance of the times affords but few of the trinkets in which that finery consists ...

In a commercial country abounding of every sort of expensive luxury, the sovereign, in the same manner as almost all the great proprietors in his dominions, naturally expends a great part of his revenue in purchasing those luxuries. His own and the neighbouring countries supply him abun-

dantly with all the costly trinkets which compose the splendid, but insignificant pageantry of a court ... The same frivolous passions, which influence their conduct, influence his'.<sup>20</sup>

The reason for concern about the deficit is due to the amount and its widespread nature but this worry also extends to cases of acceleration in the generation of deficit, which leads one to foresee greater difficulties in the near future. Adam Smith's passage obliges us to think in terms of prudence and fragility, or what is the same, in terms of correct administration of public resources, which of necessity leads us to an acceptance of budgetary discipline as an essential condition for the ordered behaviour of the public sector.

It is true that, with greater frequency than that which might be appropriate, the public sector is incited by itself and political desires to increase public spending, with or without economic justification, and that it is pressured to do so by the demands of a society which cries out for answers. Neither reason, except in cases of extreme necessity, justifies neglecting rigorous administration and renouncing the discipline required for compliance with a budget.

This deficit becomes consolidated as public debt, the presence of which in the financial markets disturbs, by means of the *crowding out* effect, the financing, with simple economic rationality, of productive activities in the private sector. The asymmetry between public and private debt in the same market is unquestionable, meaning that the presence of public debt, absorbing a significant portion of the available resources, raises the cost of private debt and hinders the possibility of its positioning as an instrument for the financing of business projects in the long term.

In Figure 13 (p. 603), we can analyse the evolution of public sector debt in relation to gross domestic product. In all cases, except the United States and Japan, for which data from the same source is unavailable, we can see the upturn in the volume of debt in relation to GDP in 2008, an immediate effect of the economic crisis. An effect which, though we do not have the corresponding data, might be expected to continue in 2009, as a result of the deficits of 2008, and indeed continue growing until the budgetary trend is reversed in those countries that manage to achieve this.

Therefore, the situation is also complex for the public sector. Its diminished credibility, in some cases more than in others, resulting from the cri-

<sup>20</sup> Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, Liberty Classics, Indianapolis 1981, Vol. II, Book V, Chapter III, pp. 908-909.

sis, leads to a clear differentiation in interest rates for the placing of debt on the market, which in turn leads to a cost differential between countries in the financing of budgetary requirements. Two aspects can be seen in Figure 14 (p. 603): on the one hand is the effect on yield of debt issued over ten years, due to the injection of financial resources in 2009 to facilitate financing, with a generalised reduction in rates for countries in the euro zone and for the United States – not for Japan – and, on the other hand, the difference in interest rates between countries depending on the criteria of the markets in respect of the securities traded. These differences range from 3.27 for German and American debt, to 4.28 and 3.97 for Italian and Spanish debt respectively. It is also significant to consider the response of the markets to financial policy initiatives by the United States and the United Kingdom. This is clearly reflected in the great fall in rates between 2007 and 2009, a sign of complacency that resulted in a fall, for the period mentioned, from 5.08 to 3.63 in the case of the United Kingdom, and from 4.68 to 3.27 in the case of the United States.

Injections of financial resources have taken two different forms. In one case, the Anglo-Saxon model, the public contribution of resources has been provided through direct intervention in the entities requiring such injection, by participating in the equity capital of the entity. In the other case, the Monetary Union model, this contribution has been made in the form of loans. In some countries this model has been presented with sufficient transparency, whilst in others it has been implemented with an almost absolute lack of transparency.

The effects of one model and another have been quite different. Whereas in the Anglo-Saxon and transparent European models, confidence in the financial system appears to have been restored, the same has not occurred in those countries of the European Monetary Union that opted for opacity. This is true to such a degree that the economic agents continue to doubt the credibility and solvency of the financial entities in these countries, meaning that financing difficulties are still present in the market.

Meanwhile, there have been frequent meetings at international level – chiefly amongst the G-7 and the G-20 – which have sought to establish economic-financial directives to combat the current crisis. Worth highlighting is the meeting of the G-20 in Washington on November 15th 2008, at which a series of measures, of a more theoretical than practical appearance, was approved. Deserving of special mention amongst these are those included in point seven of the final document and which conclude in the need to stabilise the financial system and to establish an appropriate monetary policy;

it is difficult to argue with either, though in our opinion, such pronouncements without more specific action have little impact. Along with these measures, there is a recommendation for a fiscal policy geared towards increasing domestic demand – a Keynesian solution which has proven efficient or sterile depending on historic situations – and a measure encapsulating a willingness to help the emerging economies – something that nobody would argue, although it would appear that the event held little hope as regards this matter – ultimately, the appeal of Paul VI is still relevant: ‘Today it is most important for people to understand and appreciate that the social question ties all men together, in every part of the world ...

The hungry nations of the world cry out to the peoples blessed with abundance. And the Church, cut to the quick by this cry, asks each and every man to hear his brother’s plea and answer it lovingly.’<sup>21</sup>

Pronouncements on greater transparency and responsibility in financial markets, as well as better regulation (*point 9*), do not offer specific solutions for a field in which a lack of efficiency has been detected, a lack of efficiency that has had damaging consequences for the economies of the affected countries. In *point 12*, a firm commitment to the free market is stated and this is complemented by a decisive rejection of protectionism (*point 13*), though the attitudes of governments immediately afterwards did not reflect what they had just agreed in Washington. Indeed, President Obama, on returning to the White House, immediately launched his ‘buy American’ slogan to the American people, which is just as protectionist as the ‘British jobs for British workers’ of Prime Minister Brown, or the attitude of President Sarkozy in subsidizing the French automotive industry.

Furthermore, barely three months after the Washington meeting, the G-7, meeting in Rome affirmed that ‘[P]rotectionist measures that might worsen economic slowdown will be avoided’, criticising the Obama statement encouraging the purchase of American products. The meeting concluded with the observation that, there was a need to reform and strengthen the International Monetary Fund.

#### BY WAY OF CONCLUSION

It is necessary to conclude by saying that we are facing an extremely harsh crisis, which has compromised both the real sector of the economy

<sup>21</sup> Paul VI, Encyclical letter *Populorum progressio*, Rome 26.03.1967, n. 3.

and the financial sector. Apart from its severity, the crisis has been characterised by its effect, to differing degrees, on the entire economic universe, transmitting its effects from one country to another and from one continent to the remaining continents with a hitherto unknown rapidity.

A crisis for which the traditional measures have not had the expected effects, or at least not to the degree hoped for. The real sector continues to have extraordinary financing difficulties, not only with respect to investment projects, the high cost of which has forced their postponement, but also to finance working capital. This has resulted in companies and the self-employed ceasing their activities and a continuous flow of workers to the unemployment queues.

The financial sector has not managed to recover the confidence necessary to operate with speed and flexibility in the money market. The lack of transparency of financial instruments, which was a good tool for their placement on the market amongst savers inexperienced in derivative products, has become, due to the crisis, a cause of permanent doubt with respect to solvency, thereby resulting in their retraction.

The excesses of times gone by, both in terms of consumer spending and the acquisition of property, has led families and persons to unsustainable levels of distress, unable to meet the commitments arising from contracts entered into. This has made them conservative in terms of spending and caused savings rates to grow to post-war levels, with growth being hindered by the resulting contraction in demand.

The governments of the different countries have adopted very differing positions. This ranges from those who immediately went to work to find alleviating solutions, though not complete solutions, to the economic situation, to those who with a paternalistic attitude denied the existence of the crisis for fear of generating internal problems. The latter underplayed the importance of the possible effects to be expected of the crisis, even to the point of assuring that the promised recovery had already begun and that the crisis phenomenon had gone on to become a historical event unworthy of further attention. It is obvious that the attitude of those who worked in this way only served to deepen the perverse effects of the crisis, generating damage to the national economy that might have been partially avoided if the chosen option had been that of the provision of information and the taking of measures, however unpopular.

The most visible consequence is that the governments who opted to feign the existence of a non-existent economic bonanza have accumulated economic commitments aimed at covering up what the crisis left uncov-

ered, incurring excessive deficit and generating new public debt which, due to its financing requirements, expels from the market the financing requirements of the private productive sector.

Therefore, as at all times of great economic difficulty, the consideration of objectives based on economic rationality comes to the fore, displacing ideological contemplations and dreams and leaving them for times of greater bonanza. The severe difficulties affecting persons, families and companies demand such an approach, in our opinion. We do not mind acknowledging that all of us have responsibility for what has happened in the world economy and in each nation. Starting with the families and their members, who entered into debt with too little awareness, and continuing with the companies, which, attracted by market share gains took on projects that they were incapable of managing with the resources at their disposal.

Also the financial entities, who granted loans without considering the solvency or guarantee of debtors and who issued securities guaranteed by mortgages that were incapable of guaranteeing anything; so too the governments, who were not always guided by the rationality of means and ends and by the way of truth, taking refuge in sterile ideologies which resulted in public deficit, in debt, and ultimately in harm to the people; the regulators of the financial system, both national and supranational, who perhaps forgot the essential, putting the emphasis on the transient; the supervisors of the regulations who did not exercise with due diligence in the mission entrusted to them for the correct functioning of the financial market; the rating agencies and auditors of company accounts, who failed to justify the confidence that people and markets deposited in their expert opinion.

Along with the responsibility and for purposes of greater economic rationality in the evaluation of the causes and their effects, a greater moral commitment, a greater respect for objectives and a higher incidence of ethical behaviour, far from publicity-seeking proclamations, is required. Benedict XVI said that ‘... much in fact depends on the underlying system of morality ... When business ethics prescind from these two pillars [*human dignity and the transcendental value of moral norms*], it inevitably risks losing its distinctive nature and it falls prey to forms of exploitation; more specifically, it risks becoming subservient to existing economic and financial systems rather than correcting their dysfunctional aspects ... The word “ethical”, then, should not be used to make ideological distinctions, as if to suggest that initiatives not formally so designated would not be ethical. Efforts are needed ... not only to create “ethical” sectors or segments of the economy or the world of finance, but to ensure that the whole economy –

the whole of finance – is ethical, not merely by virtue of an external label, but by its respect for requirements intrinsic to its very nature. The Church's social teaching is quite clear on the subject, recalling that the economy, in all its branches, constitutes a sector of human activity'.<sup>22</sup>

We have all had some responsibility for the current situation, and our responsibility is in proportion to our opportunity to take action and limit the effects of the crisis. Ultimately, our responsibility is not so much due to the results of our action as to the motivation of the action aimed at the solution of the problems afflicting a community. Acknowledging our weakness but assuming our commitment to the common good, our behaviour shall be aimed at a result which will ultimately depend on the will of God. 'Without God man neither knows which way to go, nor even understands who he is ... As we contemplate the vast amount of work to be done, we are sustained by our faith that God is present alongside those who come together in his name to work for justice. Only if we are aware of our calling, as individuals and as a community, to be part of God's family as his sons and daughters, will we be able to generate a new vision and muster new energy in the service of a truly integral humanism'.<sup>23</sup>

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<sup>22</sup> Benedict XVI, Encyclical letter *Caritas in veritate*, Rome 29.06.2009, n. 45. *The sentence in brackets [...] is mine.*

<sup>23</sup> Benedict XVI, Encyclical letter *Caritas in veritate*, Rome 29.06.2009, n. 78.

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## GENERAL OVERVIEW OF THE MAGNITUDE OF THE CRISIS: A COMMENT

JÖRG GUIDO HÜLSMANN

The present contribution was initially planned as a comment on the main overview paper dealing with the magnitude of the current crisis of the global economy. Because this paper could not be delivered in time, and with the encouragement of The Most Rev. Prof. Sánchez Sorondo, on the following pages I have attempted an independent comment on the impact of the crisis on persons and institutions. This explains the unusual length of this 'comment'. Upon reading Prof. Raga's excellent assessment of the magnitude of the crisis, I am happy to find that our contributions are complementary and, despite some occasional overlap, should provide a fruitful starting point for discussion. Where possible, I have added material that Prof. Raga did not cover.

### REMINDER OF THE CONTEXT

The present crisis of the global economy started with the publication of massive defaults of US subprime mortgage loans in July 2007. During the following twelve months, these initial defaults set in motion a wave of consolidation and contraction within the global financial industries. This wave has been followed by another wave of bankruptcies that swept over financial markets worldwide. The burgeoning financial tsunami has been slowed down, but not stopped, through massive interventions by the world's major central banks, which greatly expanded the money supply and eased credit conditions. In the summer and fall of 2008, it reached a climax when two of the five large US investment banks had gone bankrupt, and the three remaining banks abandoned their status and became commercial banks, in order to benefit from public bailout.

The defaults within the investment-bank sector were on the point of spilling over to a large US insurance company and to several public and semi-public banks. Within a few weeks or even days it would in all likelihood have entailed a complete meltdown of the financial markets. Few if any banks would have survived. Their failures would have set in motion a deflationary spiral. The debt-ridden global financial industries would have been wiped out. Any sort of credit – public or private – would have become unavailable. And this meltdown would have swept over the rest of the global economy: With bank credit unavailable or greatly reduced, most companies could not have financed their spending on wages, supplies, and investment. Unemployment would have soared to 30% and more. The evaporation of the value of financial titles would have drastically impaired household spending in general and consumption expenditure in particular. Retirement plans would have been in shambles.

It did not come to this point because the major governments and central banks intervened massively to bail out the threatened institutions.

A bankrupt company can be bailed out by and large only in two ways. Either one has to raise new capital to cover the losses. Or one has to create artificial markets for the products of the company. Both techniques have been applied on a massive scale starting in the fall of 2008. Central banks have been subsidising the banks through artificially low interest rates and by exchanging hundreds of billions of dollars of their relatively sound assets against the defaulting assets of the commercial banks, *at nominal values*. Governments have launched massive spending programmes designed (a) to invest public funds into commercial banks, thus partly nationalising them, (b) to provide credit guarantees for companies and households, and also (c) to stabilise respectively stimulate aggregate spending within the economy.

These policies were extended through 2009 and to the present day. Most notably, monetary policy is at present still being conducted on an acute crisis level (with interest rates close to zero, standard repo maturity of one year, and great lenience in regard to collateral).

Despite these massive interventions, the crisis of the global economy is not yet overcome, and according to most estimates is not expected to be overcome in 2010 or 2011. In several important respects, the world economy today is structurally in worse shape than before the crisis broke out. Most notably, the very measures that so far have been taken to confront the crisis have raised new problems, and aggravated some of the problems that led to the crisis.

## IMPACT OF THE CRISIS ON PERSONS AND INSTITUTIONS

*Labour Markets*

In the *European Union*, the unemployment rate has reached almost 10% out of a labour force of 236 million persons in February 2010, which corresponds to some 23 million unemployed persons.<sup>1</sup> These figures need to be put into perspective in three regards. First, EU unemployment is some 3% (or 7 million persons) up from the level of the first quarter of 2008, when it had reached a boom-induced low point; but only 1% up from the pre-boom level of the years 2002-05. Similarly, the relative weight of temporary labour contracts in the EU has decreased.<sup>2</sup> Second, these figures do not convey the greater precariousness of employment conditions due to a marginally greater weight of part-time work and of youth unemployment. Third, these figures represent only an EU-wide average. The concrete local situations differ widely. In countries such as Spain, unemployment reaches almost 20%.

In the *United States*, too the unemployment rate reached almost 10% out of a labour force of 154 million persons in March 2010, which corresponds to some 15 million unemployed persons.<sup>3</sup> These figures are up from a pre-crisis unemployment rate of some 5% or 7.5 million persons. Again, these numbers need to be put into perspective, by considering that they represent just a national average, while local conditions (for example, in the Detroit area) are often much worse. Moreover, in the US there is now relatively more long-term unemployment and more part-time work; and the numbers of those who are not counted in the unemployment statistics because, recently, they have not been looking for a job has increased and continues to increase.<sup>4</sup>

<sup>1</sup> See Eurostat, Communiqué de presse 46/2010.

<sup>2</sup> See Nicola Massarelli, *Labour Markets in EU-27 still in crisis* (Eurostat: Statistics in focus 12/2010), Table 8.

<sup>3</sup> See Bureau of Labor Statistics, *The Employment Situation – March 2010* (News Release, April 2, 2010).

<sup>4</sup> In the US, these persons are counted as ‘marginally attached to the labour force’ defined as persons who had been looking for a job at some point during the previous 12 months, but not during the 4 weeks preceding the unemployment count. Some 2.3 million persons fell into this category in March 2010. Out of these, some 1 million are counted as ‘discouraged workers’ – persons who are not currently looking for a job because they believe no jobs are available for them.

Similarly, in *Russia*, unemployment has increased to 8.9% out of a labour force of 76 million in 2009, which is up from 6.5% in 2008, respectively 6% in 2007. In other areas of the world, the crisis has not yet had the same impact on unemployment.<sup>5</sup> In *China*, unemployment stood at 4.3% out of a labour force of 813 million in September 2009, which is a slight increase as compared to 4.2% in December 2008. China had a higher unemployment rate (around 9-10%) in 2004-06, which then dropped to the present level under the impact of the boom years. India and Brazil have experienced high unemployment throughout the past decade. In *India*, unemployment stood at 10.7% out of a labour force of 467 million in 2009, which is only slightly up from 10.4% in 2008, and had been around 9% during the previous years. Similarly, in *Brazil*, the unemployment rate was 7.4% out of a labour force of 95 million in 2009, which is actually somewhat down from 7.9% in 2008, and had stayed on that level, and even higher, ever since the currency crisis of 2004.

### *Real-Estate Markets*

Real-estate markets had boomed from 2002 to 2006, especially in the Anglo-Saxon countries. They were the focal point of the unhealthy developments of the boom years. Naturally, therefore, they were first in line to be hit by the subsequent bust. In 2006, that is, at the height of the real-estate boom, the aggregate value of real estate owned by US households and non-profit organisations was 25,271 billion dollars, with outstanding mortgages of a total volume of 9,825 b\$. At the end of 2009, the aggregate value had shrunk to 18,207 b\$, while the outstanding mortgage debt stood at 10,262 b\$.<sup>6</sup> In other words, households and non-profit organisations suffered a loss corresponding to about half of the current US GDP. Again, this fact needs to be put into perspective, emphasising in particular that these are only average figures. In many individual cases the value of the real estate owned has shrunk below the value of the mortgage (negative equity). The consequence is mortgage delinquencies and foreclosures – in other words, another round of financial defaults, which at present threatens mortgage banks and thus by implication all financial industries.

<sup>5</sup> The following figures are taken from the CIA factbook.

<sup>6</sup> See Federal Reserve, *Flow of Funds Accounts of the United States* (Fourth Quarter 2009), Table B.100.

### *Capital Markets*

All over the world, stock markets collapsed in 2008, with market capitalisation declining by about 50% on average (see Table 1).

Table 1. STOCK MARKET CAPITALISATION (BILLIONS OF US DOLLARS)

End of	Americas	Asia-Pacific	Europe-Africa-Middle East	Total
2006	22 653	12 908	16 189	51 750
2007	24 320	19 792	18 615	62 727
2008	13 896	9 959	9 444	33 299

*Source:* World Federation of Exchanges; author's calculations.

As a consequence, pension funds, mutual funds, and other financial companies that were heavily invested in stocks, suffered a corresponding meltdown of their capital. A rally that took place on many stock markets during 2009 turned out to be short-lived.

This dramatic setback has entailed a massive redistribution of wealth, from the owners of capital stock to those who were invested in other asset classes (fixed income, cash, etc.). The meltdown of the stock markets also greatly impaired the possibility for companies to raise new capital on the stock markets (IPOs have plummeted and remained low), and for developing countries to attract foreign investments.

Private fixed-income securities in many cases lived through a similar setback, and several companies (such as GM) defaulted on their bonds. However, government bonds were a notable exception, especially the bonds of major governments. They actually experienced a mini boom within the crisis, because investors considered them to be a safe haven. As a consequence, interest rates on such bonds have been plummeting in the fall of 2008 and have remained low all through 2009, which has facilitated greater public debt and therefore greater public expenditure.

The great losers of the stock-market meltdown have been households. Firms and other market institutions to a very large extent have been spared thanks to government support.

### *Households*

For most families in most countries, labour is the main source of income, and the bulk of savings are usually invested in the family residence. Additional savings are invested in the capital markets or held in savings accounts with banks. The meltdown of real-estate prices combined with the meltdown of stock markets has destroyed much of this wealth. In many cases, most notably in the US, the market value of the family residence has become inferior to the remaining debt to be paid.

From an *aggregate* point of view, the net worth (total assets minus total liabilities) of households and non-profit organisations, even in the countries that so far have been most affected by the crisis, is still largely positive.<sup>7</sup>

However, the picture is different if we turn from the aggregate to *the many individual cases of families* who lost both their capital and the income from labour. For them, the disastrous events have caused much frustration and often despair. Three circumstances have so far prevented even greater suffering among those who were concerned: one, the fact that the crisis had a rather moderate impact on employment; two, in the case of the US, the relative ease of personal bankruptcy; and three, government subsidies.

Families have adjusted to the crisis by cutting expenditure, getting out of debt, and building up savings.<sup>8</sup> Much more than any other sector of the econ-

<sup>7</sup> Before the crisis (year 2006), households and non-profit organizations in the US owned a total of 77,869 b\$ of assets, and had total liabilities (essentially home mortgage, but also consumer credit) of 13,405 b\$, thus a net worth of 64,464 b\$. At the end of 2009, their total assets had shrunk to 68,178 b\$, with total liabilities at 14,001 b\$, and thus a net worth of 54,176 b\$. See Federal Reserve, *Flow of Funds Accounts of the United States* (Fourth Quarter 2009), Table B.100.

<sup>8</sup> In the case of the US, the figures are particularly striking. In 2006, US households had borrowed some 1,173 billion dollars, or roughly half of all borrowing in the US. In 2007 they decreased their borrowing to 858 b\$ or one third of the total. In the following year, they cut their borrowing to only 20b\$ or one ninetieth (!) of the total; and in 2009, for the first time in recent (or at least recorded) history, there actually was no more net borrowing, but a net payback of 237 billion dollars. Total household debt outstanding at the end of 2009 was 13,536 b\$. Similarly, in the same period, *business* borrowing decreased from 894 b\$ to -200 b\$ (i.e., also a net payback), to a total business debt outstanding of

omy, families had to solve, and did solve – and often chose in advance to solve – their financial problems the hard but virtuous way, usually under great financial and personal sacrifice. At present they still have to cope with forced sales of their property (financial titles, houses, and vehicles), with the struggle to find new employment, accepting new jobs at conditions much inferior to those that they previously enjoyed, often moving to new locations, leaving relatives and friends, remaking their lives. Those who are willing to make such efforts are often hampered by the loss of their residential property value, which in normal times would ease the move from one labour market to another.

Not all families survive shocks of such magnitude, especially not in a culture that is geared towards material success and in which uninterrupted material improvement is often taken for granted. Fragile families disintegrate under the humiliation of failure, under despair and its fruits: self-neglect and neglect of others, social isolation, violence, alcoholism, suicide, etc.

The reduction of household spending concerned in particular expenditure on education, charitable giving, and financial contributions to associations. As a consequence, Church revenues, private foreign aid, and associative life have experienced a setback. However, all in all, this setback has been moderate, so far, due to the special circumstances mentioned above.

### *Business*

In market economies, business spending is usually the citizens' main source of revenue. It is also the source of government revenue, to the extent that government spending is financed by taxes and loans to the government, which in turn are obtained out of revenue earned in firms. The *total volume* of business spending is determined by savings (and also by money production), and the concrete investment projects that are realised are determined by *relative* household spending on the various consumers' goods. The crisis has unsettled both the volume of savings and relative consumer spending. As a consequence it has unsettled both the volume and the direction of investment.

10,999 b\$ at the end of 2009; and the domestic financial sectors even more drastically reduced their borrowing from 1,294 b\$ to -1,753 b\$, with a total debt outstanding of 15,651 b\$ at the end of 2009. Only the federal government increased its borrowing from 183 b\$ in 2005 to 1,444 b\$ in 2009, and then had a total debt outstanding of 7,805 b\$ at the end of 2009. See Federal Reserve, *Flow of Funds Accounts of the United States* (Fourth Quarter 2009), Tables D.2 and D.3.

Because of the combined meltdown of real estate and stock markets, households (a) spent less, (b) spent their money differently, and (c) had less money available for saving and investment. Because of the banking crisis, bank credit in general, and bank-money creation in particular, dried up.<sup>9</sup> Because of the stock-market crisis, it was almost impossible to raise new capital. This in turn has shaken trust in the business community and impaired the availability of commercial credit, thus reinforcing the curtailment of bank credit.

As a consequence, many firms and investment projects that had been started in the boom years before the crisis were no longer viable, either because of lacking finance and/or because of shifting consumer preferences.<sup>10</sup> In other words, the structure of production was no longer adjusted to the new crisis-induced circumstances. The financial crisis had entailed, respectively reinforced, a structural crisis. As a consequence, many firms went bankrupt, many production projects had to be discontinued, and employment in those firms and projects decreased (structural unemployment).

However, not all unviable firms and business projects were in fact discontinued. A great number of them – most notably in the banking, construction, and automobile sectors – benefitted from the increased public spending designed to combat the crisis. Unviable firms and projects *by definition* destroy more resources than they create. Their preservation therefore implies a sapping of the capital basis of the economy. In the medium and long run, this will entail a reduction of aggregate production (not necessarily in absolute terms, but relative to the level of aggregate production that would otherwise have been possible) and thus an impoverishing world population.

Another factor has encouraged the same nefarious tendency. In order to overcome a structural crisis, it is not sufficient to discontinue unviable business projects that have been started in the past. It is also necessary to give new directions to investment, directions which hopefully are more in tune with present and future conditions. At present, this has not yet been achieved. In virtually all countries, private investment expenditure has plummeted during the crisis and remains low. There is a widespread reluctance of businessmen to invest, especially in long-term projects (Table 2).

<sup>9</sup> In the US, commercial and industrial loans decreased by 18.6% in 2009. See Federal Reserve, 'Assets and Liabilities of Commercial Banks in the United States – H.8'.

<sup>10</sup> It is questionable whether all of them had been viable before, because consumption and saving-investment under boom conditions is, by definition, unbalanced.

This reluctance to commit to long-term investment projects is, to a large extent, the unintended consequence of the attempt of governments and central banks to manage the crisis. Indeed, this attempt has deteriorated the business environment, most notably by aggrandising the uncertainty concerning the future evolution of the economy in four respects.

Table 2. RECENT EVOLUTION OF PRIVATE INVESTMENT IN THE EU AND THE US

Year	European Union (27)		United States	
	Billions of Euros		Billions of dollars	
	GDP	Business Investment	GDP	Gross Private Domestic Investment
2005	11 062	1 958	12 638	2 172
2006	11 682	2 126	13 399	2 327
2007	12 364	2 312	14 078	2 289
2008	12 502	2 300	14 441	2 136
2009	11 806	1 924	14 256	1 629

Source: Eurostat; Bureau of Economic Analysis; author's calculations.

(1) The momentous surge of government expenditure has been financed through a corresponding increase of public debt. In most countries, public debt had been high already before the crisis. Deficit-spending in the attempt of managing the crisis has brought it to new record levels.<sup>11</sup>

<sup>11</sup> At the end of 2008, public debt in the EU (27 countries) stood at 61.5% of GDP, and at 69.3% in the Eurozone (16 countries).

This threatens to unsettle government finance, and in several cases has already done so, bringing most notably the Greek government to the brink of default.

Government default can be prevented in three ways: (a) by cutting public expenditure, (b) by loans from other governments at lower interest rates than those practised on the market, and (c) by loans from the printing press of the central bank (monetisation of the public debt). Solution (b) can work only if some major governments have not yet accumulated a large public debt. At present, only the Chinese government is in this felicitous situation. In all other cases, the debt problem is merely shifted from one government to another. Only solutions (a) and (c) are therefore ultimate remedies against government default.<sup>12</sup> However, both solutions entail major macroeconomic disruptions, namely, deflationary spirals in the case of (a) and strong inflation or even hyperinflation in the case of (c).

Hence, one way or another, the excessive public debt of the major governments of our present day has the potential to create macroeconomic disturbances of a magnitude far in excess even of our current problems. It is true that such disaster is not yet imminent. However, if current deficit-spending goes on unchecked, and if historical experience provides any guidance, we might be only five or six years away from it.<sup>13</sup> Meanwhile, this dire prospect slows down and often stops the execution of long-term business plans, as prudent investors, who take their mandate seriously, refuse to gamble with their own family's savings, and the life-time savings of their clients, in such an uncertain environment.

Additional uncertainty in business springs from three further factors:

(2) The sheer magnitude of the changes of additional public expenditure is likely to create great fortunes where they fall. For example, in the US, the budget of the federal government has been increased, both in 2009 and in 2010, by an amount corresponding to some 10% of GDP. However, these fortunes will be gained only by those who are well positioned to deliver the goods that are then in public demand, while it is not always clear which goods will be concerned and when.

<sup>12</sup> Only solution (a) is a *genuine* ultimate remedy against government default, because solution (c) amounts to covert default.

<sup>13</sup> On the theory and history of hyperinflations, see Peter Bernholz, *Monetary Regimes and Inflation* (2003).

(3) This expenditure is for the moment essentially short-term, while it is not clear if and to which extent these public spending programmes will be extended.

(4) Various legislative processes, initiated by the heads of major states, have been announced to bring about sweeping changes to business regulation and sometimes even to the whole structure of the economy. In some cases a relatively concrete objective of these changes is announced ('green economy'), while their dimension remains unclear and the measures (public spending, business regulation, etc.) remain vague too. In other cases, even the objective is elusive ('ending capitalism', 'empowering the state') and as a consequence the political measures cannot yet be ascertained either.

Each of these four factors creates policy-induced or regime uncertainty, which impairs long-term investment.<sup>14</sup> Taken together, they go a long way accounting for the current stifling of business investment, which, if it persists, threatens to undermine in the medium and long run the material welfare of the world population.<sup>15</sup>

### *Banking*

Even more so than the stock markets, the banking sector has been the epicentre of the current crisis. Much less than the stock markets, banks have been penalised for their own excesses, which had, after all, contributed quite substantially to magnitude of the crisis. Out of the 7,401 US chartered commercial banks that were in operation in 2006, since the outbreak of the crisis in July 2007, more than 200 have so far been closed in an accelerating wave of bank failures. At present, this wave is still in full swing (Table 3). In the first few months of the present year, until April 23, no less than 57 banks have failed and been closed.

<sup>14</sup> On the theoretical and historical significance of the concept of regime uncertainty, see Higgs (1997).

<sup>15</sup> GDP component figures portray the production, consumption, and distribution of the monetary value of the annual consumer-good production. They include *additions* to the capital structure ('Gross Fixed Capital Formation'), but do not take into account the expenditures made to *preserve the current capital structure*. For example, when business expenditure plummets (with the near-term consequence of capital consumption), this does not have an immediate negative impact on *real* GDP, because in the short run the economy continues to churn out the consumers' goods that have been close to completion; and *nominal* GDP might actually increase, to the extent that some of the funds that would otherwise have been invested are now being used for consumption expenditure.

Table 3. NUMBER OF BANK FAILURES IN THE UNITED STATES

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010 (April 23)
2	4	11	3	4	0	0	3	25	140	57

Source: Federal Deposit Insurance Corporation.

In the EU, the number of bank failures was much smaller, essentially because the European governments were much more determined to prevent bank failures with the help of open and hidden subsidies. This concerned in particular public and semi-public banks. In Germany, the Länder-owned *Landesbanken* had massively invested in mortgage-backed securities (MBS), which they had bought, as it turned out, at excessively high prices. Only public bailouts did prevent their bankruptcy. In the US, things were similar. Several government-sponsored enterprises (GSE) were at the forefront of those who had based their strategies and operational choices on excessively optimistic assessments of MBS values, which brought them to the brink of failure. The three big GSE in US finance are the National Mortgage Association (GNMA or Ginnie Mae), which issued the first mortgage security in 1970; the Federal Home Loan Mortgage Corporation (FHMLC or Freddie Mac); and Federal National Mortgage Association (FNMA or Fannie Mae). Freddie Mac and Fannie Mae control an aggregate balance sheet of some 5 trillion dollars. In the fall of 2008, they were bailed out.

Just as the private commercial banks and investment banks, public and semi-public banks engaged in business practices that have been fragilising the financial system as a whole, and which have decisively contributed to the magnitude of the current crisis. Three such business practices can be singled out:

1) Banks have operated with extremely low cash balances, which made them vulnerable to bank runs, which respectively made them dependent on permanent assistance from the central banks to prevent bank runs. They have done this to invest the money that would otherwise have been 'idle' in their cash balance, thus profiting from the return on this investment.

2) Banks have operated with extremely low equity ratios in an attempt to leverage a higher-than average return on equity capital. This technique of leveraging, and the implied under-capitalisation, is pervasive on the financial markets and their most serious structural problem. It accounts for

much of the magnitude of the current crisis. Banks typically operate with equity ratios of much less than 10%, and in the case of large GSE such as Fannie Mae and Freddie Mac, their equity ratio was in the order of a mere 1% (!). Consider the following example. Suppose an investment, entirely made in the form of equity capital of 50 m€, yields a net profit of 5 m€. This is equivalent to a return on equity (ROE) of 10%. Now, if the investment is no longer entirely financed by equity, but in a more or less large part by debt, then the net profit diminishes (because the investor has to pay interest on the debt), *but it increases relative to the equity capital that is still invested*. Thus, if 45 m€ out of the 50 m€ investment are financed through a credit at 5%, then the net profit is  $5 \text{ m€} - 45 \text{ m€} \times 5\% = 2.75 \text{ m€}$ . But this net profit of 2.75 m€ is now the remuneration of only 5 m€ equity capital. In other words, it represents a ROE of 55%. This technique can conceivably be applied ad infinitum, as long as the total return on investment is higher than the cost of credit. Thus, suppose the above investment is financed by 1 m€ equity capital and 49 m€ of debt. Then the net profit is  $5 \text{ m€} - 49 \text{ m€} \times 5\% = 2.55 \text{ m€}$ , representing now a ROE of 255% (!).

3) Banks have systematically invested too much money in relatively high-return (but also, therefore, high-risk) assets. Or, what amounts to the same, they have systematically underestimated the risks associated with these assets.

As we have stated, these practices have long been pervasive. It is obvious that they engender a higher profit respectively a higher return for the investor, at the cost of greater vulnerability. Interest-rate hikes, unexpected reductions of revenue, unexpected technical problems, etc. can easily upset the calculus of the ardent risk-taker, and then he quickly faces insolvency, especially if he has reduced his equity basis to an almost symbolic minimum. Now, if only one or a few banks are such excessive risk-takers, then they alone become vulnerable, while their behaviour represents no threat for the banking system and the financial system as a whole. But if more or less *all* banks choose to apply these financial techniques on a massive scale, then they all become vulnerable. And because the assets of one financial firm are more than often the liability of another, the failure of one of them, if sufficiently large, is likely to trigger a snowball of further failures. Such firms, which are big enough to trigger snowballing failures, are 'systemically relevant' in current economic jargon.

These problems, and in particular the pervasive problem of undercapitalised financial agents, have been known to public banking supervisors for many years. It is true that nobody was able to predict the exact timing and

the extent of the current crisis. However, many economists, some of them associated with government financial institutions such as the Bank for International Settlements and the St. Louis Fed, ever since the acceleration of the US real estate boom in 2002, had warned in scholarly articles, in the daily press, and in public speeches that it was but a question of time until these structural problems would usher into a new crisis. They have at times been heard, but governments have not listened to them. In short, there was no lack of intelligence, but there was a lack of political will to tackle the issues.

One of the factors that paralysed the determination of governments to solve these problems in time is their self-interest in preserving inflationary (that is, leveraged) finance, and in promoting rather than curtailing the banking industry's credit-creation powers. Now, it needs to be stressed right away that this is not a recent phenomenon, but a constant feature of mankind's financial and monetary history. Until the 17th century, governments have sought and obtained inflationary finance through the debasement of the coinage, which by the way was severely reprimanded by the Catholic Church. Then they discovered that the same end could be reached much more cheaply and much more safely and efficiently by banks that produced redeemable paper notes and demanded deposits on a fractional-reserve basis. They therefore started to create such banks on their own account, and encouraged similar initiatives from businessmen and financial promoters.

The central problem of bank-based inflationary finance is the virtual illiquidity of the banks. It is impossible for them to redeem all of their notes and deposits at once, even though they give a promise of immediate redemption to each bearer of their notes and to each owner of a deposit. If the banker correctly speculates on the volume asked for redemption, the virtual illiquidity remains just that – virtual. However, it turns into manifest illiquidity if the banker is a poor speculator. And such illiquidity very quickly turns into insolvency if, as is often the case, the banker has to force-sell his assets to replenish his cash balance. And the insolvency of one banker more than often snowballs into the insolvency of others, as everybody scrambles for cash and is forced to sell. In short, with the new banking industry there appeared the new phenomenon of the banking crisis.

While the banking industry was young, its crises were small too and did not have much impact on the rest of the economy. But when it grew into importance at the end of the 18th and through the middle of the 19th century, its crises became a nuisance for public finance. Thus governments sought to prevent bank runs and financial crises by the institution of central banks, starting with the Bank of England in 1844.

These new institutions centralised the country's reserves of base money, which at the time was usually a currency of silver or gold. Thus they could bail out the other banks in times of liquidity crises. However, this institutional solution was short-lived because it did not attack the problem of inflationary finance at the root; rather, it aggravated the basic illiquidity problem, which was soon 'reproduced on a larger scale' as the Marxists used to say. Central banks were supposed to preserve, not to curtail, the ability of commercial banks to inflate the money supply, and thus to inflate the supply of bank credit. They themselves were operating on a fractional-reserve basis, even though they were not quite as much leveraged as the other banks. Not surprisingly, the commercial banks did not diminish their issues, but on the contrary increased them. They did not increase their equity capital to have a greater buffer in bad times, but increased their leverage because they knew the central banks behind them. This behaviour was rational from their individual point of view, given the incentives that had been created through the centralisation of the reserves. The new institutional environment had made them less responsible for their actions. They no longer had to shoulder the full negative consequences of their choices, yet they still enjoyed all the benefits (current economic jargon calls this 'moral hazard'). They acted accordingly, and the system as a whole therefore became much more leveraged and fragile. In short, the centralisation of banking ultimately reinforced the problems of fractional-reserve banking, by making the industry as a whole more fragile. As a consequence, financial crises became even larger, threatening the entire banking system as well as government finance, and increasingly had international ramifications.

Again, governments stepped in to rescue the banking system, yet again, at least in part out of self-interest, without going to the root of the matter. The new solution consisted in (a) giving legal tender status to the money substitutes issued by central banks and (b) granting the central banks the right to suspend their payments. This implied that central-bank issues were no longer redeemable into some underlying natural base-money such as gold. Rather, these issues now were the base money of the country. This is the origin of the present system of immaterial fiat monies, which underlies the architecture of global finance.<sup>16</sup>

<sup>16</sup> For a more detailed account of the evolution of western monetary systems, see Hülsmann (2008), part three.

To understand the economic consequences of immaterial fiat money, one has to realise that in such a monetary system there are no more technical or commercial limitations to the production of base money. Under a silver standard, or a gold standard, the production of base money is constrained by the costs of mining and minting. No such constraints exist in our present fiat money system. Central banks can produce money in unlimited amounts and with virtually no time constraint either. This implies most notably that a central bank cannot go bankrupt as long as its debts are denominated in its own currency. Similarly, no public or private organisation can go bankrupt as long as it enjoys the unmitigated solidarity of the central bank that produces the money that it has to pay back.

This institutional solution promotes moral hazard on an even greater scale than the system it had replaced. The very presence of central banks producing immaterial paper money, which moreover have the official mission to stabilise the banking sector and the financial markets, *encourages precisely those nefarious practices that we have singled out above*. Thus, commercial banks run down their cash balances because they can obtain cash in unlimited amounts and at a moment's notice at the trading desks of the central banks. Commercial banks run down their equity ratios as far as legally allowed, because there is no more need for them to take any precautions against adverse market tendencies. Indeed, (a) the monetary values of their assets are stabilised through the central banks and (b) they themselves are 'systemically relevant' and can therefore expect to be bailed out in the worst of all cases. Finally, for the same reason, commercial banks make riskier investments. Indeed these risks do not fully fall on them. A significant part of the risks is 'socialised' through public bailout money.

These practices cannot be fully prevented through the control mechanisms that are successfully applied in other areas. In particular, credit rating and bank audits are hapless in markets that are fundamentally biased by the presence of a pervasive moral hazard. Rating agencies and auditors rely on past and current market prices to assess the possible benefits and risks of a firm's operations. But those very prices are being negotiated by agents that are not fully responsible for their actions. The prices 'lie'.

Similarly, financial regulation is ultimately powerless in the presence of institutionalised moral hazard, as long as it leaves the banks any freedom of choice to innovate and develop new products and markets. The minimum capital ratios imposed on the banking system starting in the 1990s (under the Basel I agreements) have merely shifted the locus of excessive behaviour. Banks have developed a whole panoply of new financial tech-

niques, most notably securitisation, to get around those rules in all legality. Often this has been done with the connivance of public and semi-public partners. For example, under the Basel rules, private-sector claims have to be secured by a minimum equity ratio of 8%. But if a GSE such as Freddie Mac holds these claims and uses them as backing for some new asset-backed securities (ABS) that it sells on the market, then a commercial bank that buys one these ABS has to secure this purchase by a mere 1.6% of equity, even though the underlying asset (and thus the underlying risk) has not changed in the least.

In the past, financial and banking regulation has been 'captured' by the very firms, usually major firms, which were supposed to be regulated. These firms used the regulation process to fight competitors whom they could not successfully confront on the market. Financial and banking regulation has also been full of exceptions and exemptions designed to allow inflationary finance in the service of the state. For example, again under the Basel rules, any credit granted to a national government does not require any equity basis at all.

The institutional fragility of the global financial sector and of banking in particular is therefore quite essentially the result of rational individual adjustments to an ill-conceived institutional environment. Banks have not mindlessly followed a greedy appetite for greater profits and market shares, not caring for the downside this could have in store for them. They have not just mimicked other banks, or other investors, who applied hazardous strategies. Quite to the contrary, they have coolly and rationally pondered the pros and cons *for them*. And the turn of the events of the past two years demonstrates that the bankers have been right, at least as far as their own business is concerned. Unsound practices in finance and banking have, as a rule, *not* been penalised through bankruptcy. To the contrary, as a rule, they have been rewarded by bailouts in the form of expansionary monetary policy, credit guarantees, and direct subsidies (partial or full nationalisations). These bailouts have been justified with the 'systemic relevance' of those banks and financial firms. Their executives are therefore encouraged to count on similar bailouts in the future.

This amounts to no less than a destruction of the incentive system without which a market economy cannot operate. When profits are private, while losses are socialised, the beneficiaries are encouraged to behave in ways that are no longer conducive to the common good. Neither are they encouraged to behave and think in ways that is conducive to their own good as persons. The permanent public assistance distorts their character.

Pope John Paul II once observed:

By intervening directly and depriving society of its responsibility, the Social Assistance State leads to a loss of human energies and an inordinate increase of public agencies, which are dominated more by bureaucratic ways of thinking than by concern for serving their clients, and which are accompanied by an enormous increase in spending.<sup>17</sup>

This passage from *Centesimus Annus* is usually thought to apply to unemployed welfare receivers. But it applies just as well to 'welfare for bankers' even though the assistance from which they benefit is less open.

To sum up, long-standing political interventions into the monetary system were primarily designed to preserve inflationary finance in the service of the state (and of others). These interventions have entailed (a) an increase of the overall volume of the banking sector relative to the rest of the economy; (b) a concentration within the banking industry, which set in when regulations were set up which slowed down the creation of new banks; and (c) a greater overall fragility of the banking industry, as manifest in under-capitalisation.

The current crisis does *not* provide clear-cut demonstration that free and unfettered financial markets just cannot work, but rather need vigorous political control to be conducive to the common good. The evidence for this often-made assertion is weak, if not outright lacking. A much stronger case can be made for the exact opposite claim, namely, that current crisis delivers yet another demonstration that political interventionism just does not work, and that only the genuinely free (and responsible) actions of entrepreneurs and other market participants can make financial markets operate to the benefit of the common good.

Without even entering into any detailed argument, the basic and widely known institutional facts lend *prima facie* credence to this claim. As a starter, in historical perspective, financial markets and financial agents (especially banks) are, to a large extent, political creatures. The history of organised financial markets is very much the history of governments trying to make sure there are enough buyers of government bonds.<sup>18</sup> The history of banking is very much the history of money creation in the service of the state.<sup>19</sup> In our

<sup>17</sup> John Paul II, *Centesimus Annus*, § 48.

<sup>18</sup> On the early history see Ehrenberg (1896).

<sup>19</sup> See for example Gouge (1833), Rothbard (2002).

own day, banks are often state-owned, and in all other cases they are licensed by public administrations according to rules fixed by legislation.<sup>20</sup> On the financial markets, governments feature a massive presence, not only as regulators, but also as financial agents, and especially as elephant consumers of financial services. The major governments of the world taken together absorb a good third of the world's savings. Financial markets are not free from political intervention, not by any stretch of the imagination and of common grammar.

### *Governments*

Apart from the top echelon of banking, government – especially the governments of major countries, in economic terms – has been the only sector to benefit from the current crisis. Governments all over the world have assumed the mission to manage the crisis and thus to bring the world economy back on track. The essential means have been greater public spending and further regulations of the financial markets and other sectors of the economy. The bulk of these activities have taken place on a national level, but regional and communal governments have often mimicked the same approach. The result has been an across-the-board momentous surge of public spending. The order of magnitude has very often been in the double digits of GDP. Virtually all of this additional spending has been financed by an increase of public debt.

At the risk of belabouring the obvious, it should be noted that the momentous growth of government activity (including central banking) at the onset of a crisis is not an inescapable law of nature. Rather, it is a characteristic fruit of the culture of statism that has come into dominance in the 20th century and is today deeply entrenched in the political class and its organisations, as well as in public administrations, in education, in higher education, in religious organisations, and in the media (with the exception of the Internet). Statism can be defined as an exaggerated belief in the power of political interventions to create, respectively to restore, a beneficial social order.<sup>21</sup> In its mildest form, it holds that such interventions, *if* used

<sup>20</sup> Overview in Barth *et al.* (2005).

<sup>21</sup> Political interventions must not be confused with a mixed economy. In the latter, the government is one of several owners and it controls only its own property. By contrast, an interventionist government commands other property owners to use their resources in a different way than these owners themselves would have used them. See Mises (1977[1929]), chap. 1.

wisely and as a complement to the order-creating activities of civil society, may benefit social order. In a stronger form, it holds that political interventions are always a necessary element in creating social order, though they may be counter-productive if used without circumspection. In its most extreme form, it does not recognise any limitations to the power of the state in realising its objectives (fiction of government omnipotence). Statism is grounded on various factual claims. It is therefore open to be challenged by scientific enquiry and is, indeed, being challenged constantly.

Government management of the present crisis rests on three related claims, namely (1) that interventionism has not itself been a major cause of our present calamities; (2) that further interventionism is a suitable means – possibly the only means – to bring the world economy back on track, and (3) that interventionism has worked on similar occasions in the past, most notably in combating the Great Depression of the 1930s. All three claims are at the centre of current debate.<sup>22</sup>

In any case, increased government activity (including central banking) in the name of economic problem-solving means an increased role of government within the economy and society. Individuals, families, firms, associations, and communal governments are learning to rely, both in addressing present concerns, and in their planning of future activities, on the very same political institutions: national governments and their supra-national institutions. In short, civil society and civil institutions become less self-reliant, while political power is being enhanced and centralised.

This tendency of turning governments and their institutions, including central banks, into ‘problem-solvers of last resort’, far from putting society on a more solid footing, makes the social fabric as a whole more fragile. On the one hand, the manifold prudential measures for economic self-protection, taken by individuals and civil institutions in the light of their different subjective assessments of present and future risks, are homogenised. On the other hand, the overall volume of economic self-protection is reduced because of the economies of scale implied in centralised all-risk economic insurance offered by the state. In short, the buffers and cushions of the social fabric, providing protection to each against the errors and abuses of others, dwindle

<sup>22</sup> Out of the very rich literature criticising the notion that governments should manage economic crises, or have successfully managed such crises in the past, see for example Woods (2009), Salin (2010), Paul (2009), Huerta de Soto (2006), Rothbard (2005), Higgs (2006), Powell (2003), Shlaes (2007), Taylor (2010), and Altmiks (2010).

in orientation, number, and overall volume. The expansion and concentration of political action implies that any errors in government (and, *a fortiori*, abuses of government power) have a greater and immediate impact on all members and institutions of civil society. The reinforcement of political institutions entails increased overall institutional fragility. In the words of current economic jargon, it creates respectively increases systemic risks.

The evolution of western banking, which we have briefly reviewed above, stands as a warning illustration of this dangerous tendency.

From a political point of view, increased government activity (including central banking) forebodes ill for the preservation of free societies, even if the current expansion and centralisation of government power is meant to be temporary. Indeed, throughout the 20th century and into our day, temporary increases of government power to confront a military or economic crisis have never been fully scaled back after the crisis had been overcome.<sup>23</sup> All in all, there has been a secular tendency for government to grow at the expense of civil society, with only a few occasional and minor setbacks.

#### SUMMARY

Our overview of the main features of the current crisis of the global economy, up to the present point (April 2010), can be summarised in eleven points:

(1) The magnitude of the current crisis of the global economy results especially from the fragility of virtually the entire financial sector, which is too weak to reform itself and too weak to accommodate sudden and major adjustments in business.

(2) The fragility of the financial sector has been known for many years. Governments have neglected to address this problem, *inter alia*, because of their own material self-interest.

(3) The major manifestation of the crisis so far has been the dramatic meltdown of stock markets on a worldwide scale in the year 2008, and the implied massive redistribution of wealth, essentially to the detriment of households.

(4) The crisis did not entail an institutional meltdown because of immediate and massive action of public authorities (central banks and national

<sup>23</sup> This is known as the 'ratchet effect' of government expansion. See Higgs (1977).

governments). In particular, the momentous expansion of government and central-bank *spending* has prevented a great number of bankruptcies in the financial industries and in other sectors of the economy.

(5) Because of (4), unemployment has been kept at a relatively low level, as compared to major crises in the past, even though there are significant regional disparities.

(6) Because of (4), many unviable firms and business projects have been kept in existence, which sap the capital basis of the economy and thus undermine the future productivity of labour.

(7) Because of (4), the incentive system of the market has been further eroded, especially in the 'systemically relevant' banks and financial firms. The resulting waste of capital undermines the future productivity of labour.

(8) Because of (4), public debt has reached critical levels in several countries. If unchecked, it threatens to entail major macroeconomic disruptions.

(9) Because of (4), the network of social institutions is becoming more fragile, and systemic risks are building up.

(10) Because of (4), political freedom is being undermined.

(11) Because of (4), and also because of current legal activism motivated by the desire to 'use the crisis' to impose social change, have deteriorated the business environment and slowed down private investment.

All in all, therefore, the crisis of the global economy is far from over. Due to immediate and vigorous bail-out interventions on the part of the major central banks and governments, much human suffering has so far been prevented. However, this achievement has been essentially short term in nature, and it has been bought at a great price.

Fundamental structural problems of the world economy (both in business and in finance) have not been solved, and often reinforced through the bail out. Virtually all banks and financial firms are still seriously under-capitalised, a great number of industrial firms survive only thanks to overt and hidden subsidies, and private investment in general is slugging. The massive interventions of central banks and governments have also created respectively aggravated other problems, such as the institutional fragility of civil society (systemic risks), the erosion of political liberty, the undermining of public finance (potential of major macroeconomic disruptions in the near future), and the further erosion of entrepreneurial responsibility, one of the pillars of a genuine market economy.

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# THE CURRENT CRISIS: CONSEQUENCES OF NEGLECTING THE FOUR KEY PRINCIPLES OF CATHOLIC SOCIAL DOCTRINE

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## THE SILENCE OF THE SOCIOLOGISTS

When the Berlin Wall fell, Peter Berger berated sociologists for not having seen this coming and for producing precious few analyses of why it had. On the first charge, many joined ranks with those of us who had never held the discipline to be a predictive science<sup>1</sup> because open systems, such as society, are always subject to the intervention of contingencies. On the second charge, there was no ready hiding place and only the shameless took refuge in the plea that this was the task of political science or international relations. Exactly the same response greeted the recession in 2007. The few sociologists who did produce media comments also called it 'the credit crunch', as journalists themselves had misleadingly labelled it.

Whilst it would clearly be inappropriate to expect sociologists to supply a detailed analysis of the proximate economic causes of the recession, the same is not the case for an explanation of the socio-cultural context that enabled this type of phenomenon to happen. However, the requisite conceptual tools for such a contextual analysis were lacking. This also precluded the specification of transformed social conditions that would constitute a barrier against recurrence.

On the contrary, I will argue that the generic conceptualization of agency (socio-economic agents) and structure (social institutions) were part of the contextual cause rather than its cure. Sociological concepts have

<sup>1</sup> See Roy Bhaskar, 1989, *The Possibility of Naturalism*, Hemel Hempstead, Harvester Wheatsheaf.

regularly migrated into popular usage, being more accessible than economic ones, and this has intensified as mainstream economics has become pre-occupied by economic modelling.<sup>2</sup> Conversely, from the 1970s onwards there was a steady abandonment of 'systematic sociology' and the almost feverish production of 'catch-phrase' caricatures, each merely extrapolating one societal feature observable at the empirical level (e.g. 'information or knowledge society', 'risk society', 'liquid society', 'Macdonaldized society' and so forth). Their very superficiality facilitated media take up and speeded the hermeneutic normalization of their basic assumptions as they trickled down into the population at large.

The reverse face of the coin was that interest in non-observable generative Mechanisms – those producing structural and cultural contradictions and complementarities or agential integration rather than conflict – were subject to a further barrage of criticism that the stratified social ontology involved entailed reification. Significantly, Bruno Latour entitled one of his chapters 'How to Keep the Social Flat'.<sup>3</sup>

In this paper I need to dwell partly upon why current sociology could contribute so little to our understanding of the recession *in order to show* that it collaborated in constituting a context – of institutions and organizations and of general understandings and expectations – that provided fertile ground for the practices that were proximately responsible for the crisis unfolding. Correspondingly, I will seek to show that each of the rather gross contributory causes to the recession that sociologists have helped to create are at variance with the key principles of Catholic Social Doctrine.

The defective conceptualizations in question where current sociology is concerned are the following:

1. Its models of the human being (and hence of agency) are predominantly individualistic, although in very different ways. *Individualism* is held to be one of the core features of the cultural context which enabled the types of proximate actions precipitating the crisis.
2. From such models it is not possible to conceptualise a form of political organization (or political philosophy) that would have been resistant to the practices of unrestrained financialization on the part of their rich protagonists or the ready acquiescence of poorer participants. This served to

<sup>2</sup> Tony Lawson, 1997, *Economics and Reality*, London, Routledge.

<sup>3</sup> Bruno Latour, 2005, *Reassembling the Social: an introduction to actor-network-theory*, Oxford, Oxford University Press.

buttress an institutional political context which was unwilling to regulate the financial activities that were directly responsible for the recession.

3. Generically, the majority of today's social theory has no resources with which to conceive of a robust civil society and a real civil economy that would have been bulwarks against the scenario which unreeled. With Marxism dead, so was the power to conceive of a better future attained through social conflict. With Parsons in demise, so died any serious concern with social integration and 'the problem of social order'. The two main engines that, in totally different ways, had driven the sociological imagination during industrial capitalism generated no alternatives for the macro-conceptualization of how late modernity need not 'be so, but could be otherwise'.

#### 1. INDIVIDUALISTIC MODELS OF THE HUMAN BEING HOSTILE TO HUMAN WELL BEING

1.1. *Homo economicus* is a model of the human being – most explicit in Rational Choice Theory – who contributes nothing to the 'common good', unless by accident, and is unmoved by his social *relations*.<sup>4</sup> This atomistic individual is devoted to and never diverted from the pursuit of his own 'preference schedule'. His preferences themselves are not necessarily either self-ish or mercenary but, nevertheless, their attainment leaves him better off in his own preferred terms. 'Economic man' is thus someone whose human constitution owes nothing to society, sustains no social bonds and is thus a self-sufficient 'outsider' who simply operates in a social environment. *Homo economicus* is a model which has stripped down the human being until he or she has one property alone, that of instrumental rationality, namely the capacity to maximise his preferences and so to maximise his utility.

Far from being confined to economic behaviour, this model has been extended to account for why we have children, visit our aged parents, attend one church rather than another, and how we select our spouses.<sup>5</sup> This is a model of 'man' who contributes nothing to social solidarity and is

<sup>4</sup> Margaret S. Archer, 2000, 'Homo economicus, homo sociologicus and homo sentiens', in M.S. Archer and Jonathan Q. Titter, *Rational Choice Theory: Resisting Colonization*, London Routledge.

<sup>5</sup> Gary Becker, 1996, *Accounting for Tastes*, Harvard University Press, Cambridge, Mass.

also puzzled by it. If all were like him, there would be no voluntary collective behaviour leading to the creation of public goods (such as litter free public spaces) let alone the large network of voluntary associations. Neither would there be any collective acts of solidarity and free-giving (the normal response to humanitarian crises and natural disasters). These *human* actions and responses are beyond the repertoire of *homo economicus*.

The main reason why we should have no truck with *homo economicus* or an economy and society modelled upon such an impoverished notion of the human being, is that it cannot cope with our capacity to transcend instrumental rationality and to devote much of our energy to our 'ultimate concerns'. These are concerns that are not a means to anything beyond them, but are *commitments that are constitutive of who we are* – be they our children, Church, career, community or cause – and thus our *relations* are the basis of our personal identities.<sup>6</sup> None of this caring can be impoverished by reducing it to an instrumental means-ends relationship, which is assumed to leave us 'better off' relative to some notion of future 'utility'. Yet, it is only in the light of our 'ultimate concerns' that our actions are ultimately intelligible. Hence, we should resist being reduced to 'one-dimensional people' by a model that leaves out those social bonds that are humanly most important to us.

1.2. Bureaucratic regulation works with a different model of the human being but one that is equally one-dimensional, namely *homo sociologicus*. This model does not immediately appear as individualist, but note that co-operation with others is self-motivated and derives from something equivalent to a *contractual* social bond. Indeed, the model itself originated from Hobbes' individualistic theory of social contract. This model comes into play when people have to recognize their interdependence with others and the need to co-operate, rather than engaging in self-defeating antagonism. It entails assuming a role – whether that of employee or a claimant of benefits – and all roles have norms and normative expectations associated with them. These norms govern not only, for example, hours of work, but also entail detailed expectations about appropriate behaviour on the job. Role occupants are assumed to live up to these expectations because of the sanctions related to role-breaking thus, again, harking back to the Hobbesian

<sup>6</sup> Margaret S. Archer, 'Persons and Ultimate Concerns: Who We Are is What We Care About', 2006, in E. Malinvaud and M.A. Glendon, *Conceptualization of the Person in the Social Sciences*, Proceedings of the Eleventh Plenary Session of the Pontifical Academy of Social Sciences, Vatican City.

notion that co-ordinated action between people has to be regulated and orchestrated from above, if it is not to collapse into aggression over conflicting individual interests. Occupants of roles do not have to subscribe to the expectations involved, so long as they obediently fulfil the role requirements. However, it is obviously advantageous that they do internally endorse the norms in question because less supervision or surveillance is needed as they carry out their tasks.

Although not overtly individualistic, as is *homo economicus*, not only does self-interest lie behind it but also the formal requirements of role definitions, i.e. the strict delimitation of where responsibilities begin and end, are hostile to genuine co-operation. One of the main problems of this view is that the more an organisation succeeds in turning its personnel into *homo sociologicus* (or ‘Organization Man’) the more they become subservient ‘dopes’ – extinguished as people and without the initiative to act when the small-print runs out. Thus de-humanization accompanies organizational ineptitude, especially when unforeseen contingencies arise – which in a classroom, for instance, is nearly all the time.<sup>7</sup> How many times have we all been frustrated by the response to a phone-call to a bank, business, or public utility telling us, ‘Our system doesn’t allow that’? Instead of people extinguishing themselves by conventionally following regulations, which cannot even cover the first emergency, we need moral agents who invest themselves in occupational roles and personify them in their own way, like the memorable stimulating teacher or the work-mate who lends a hand in finding the way round a problem.

The rejection of *homo sociologicus* has always been one reason for the Church’s Social Doctrine advocating the principle of Subsidiarity.<sup>8</sup> Subsidiarity rejects the ‘top-down’ regulation of all co-operative human activities. Hence, the best-known aspect of this teaching – that a ‘higher’ agency should not usurp control of activities that can be performed by a ‘lower’ one. In other words, the State should not strip the family of functions that families can perform better than bureaucracies; rather, it should assist them (by

<sup>7</sup> In Britain, towards the end of May 2010, a boy died of asthma in a school corridor having been sent to stand there when he experienced breathing difficulties. Seven members of staff are now under investigation.

<sup>8</sup> See Russell Hittinger, ‘The Coherence of the Four Basic Principles of Catholic Social Doctrine – An Interpretation’, in Margaret S. Archer and Pierpaolo Donati (eds.), 2008, *Pursuing the Common Good: How Solidarity and Subsidiarity Can Work Together*, Proceedings of the 14th Plenary Session of the Pontifical Academy of Sciences, Vatican City.

the *subsidium*) in carrying out their duties. This is the negative side of the principle of *subsidiarity*. However, the positive side is even more important, because without it there would be nothing in whose name to resist state intervention. In the Church's conception, human beings are 'gifted servants'. They are people with gifts or talents (*munera*), willing to serve others in need and form fellowship with them. In this, they should be encouraged by 'higher' authorities rather than being regulated or incorporated into the State apparatus. At the level of individual free-giving, it is salutary to note that when blood donors were financially rewarded in the U.S., both the numbers of donors and the quality of the blood given declined.

1.3. The newest version of individualism repays attention because it has explicitly given up on the macro-social order being amenable to collective guidance. Late Modernity is characterised by Giddens as the 'runaway society', the 'juggernaut' out of control, and similarly by Beck as a cluster of globally dangerous and uncontrolled 'side effects'. Corresponding to this is a 'categorical shift' in the relation between the individual and society'.<sup>9</sup> *Risk Society* had emphasised the contemporary *disintegration* of entrenched structures from which people had been 'liberated' and, in consequence, propelled towards 'individualization'.

Globalization has, it is held, increasingly freed people from the traditional restraints of 'common values' and replaced the burden of conformity with the imperative of elaborating a 'self-culture' and expressing it in 'a life of one's own'. In parallel, the traditional social groupings structured by industrial society (class, status and gender) *dissolved*, thus shattering the frail unity of shared life experiences which had lasted until the 1950s. Thereafter, individuals became 'disembedded' from the old ties of kinship, neighbourhood, regional culture and geographical location, which intensified the '*dissolution* of lifeworlds associated with class and status group subcultures'.<sup>10</sup> Gone were the old industrial 'zombie categories', such as social classes or housewives, which encouraged their members to coalesce in solidarity. 'In the place of binding traditions, institutional guidelines appear on the scene to organize your own life...*The crucial difference is that modern guidelines actually compel the self-organization and self-thematization of people's biographies*'.<sup>11</sup> Not only are individuals *compelled* to develop

<sup>9</sup> Ulrich Beck, 1992 [1986] *Risk Society: Towards a New Modernity*, London, Sage, p. 127.

<sup>10</sup> Ulrich Beck and Elizabeth Beck-Gernsheim, *Individualization*, London, Sage, 2002, p. 31.

<sup>11</sup> *Individualization, Ibid.*, p. 23-4 (my italics).

elective 'do-it-yourself biographies', but are also newly burdened with sustaining this tightrope act, with daily renewing their interpersonal relationships (love, marriage, parenthood) and also charged with regularly updating their own self-determined choreography of life.

A network of regulations, conditions, and provisos mean that individualization does not represent unfettered subjectivity. Nevertheless, 'liberation' from traditional structural constraints and the proportional surge of individualization means that, 'under the tidal wave of new life designs, of do-it-yourself and tightrope biographies', the 'structures of the "social" are having to be renegotiated, reinvented and reconstructed'.<sup>12</sup> In other words, any notion of a 'systemic' level, with sufficient durability for its properties and powers to be disengaged, activated, and exerted has been rendered obsolete. Therefore, it is unsurprising that Beck and Beck-Gernsheim conclude that their analysis has nullified the premise of 'social-structural analyses' because, '[w]ith the emergence of a self-culture, it is rather a *lack* of social structures which establishes itself as the basic feature of the social structure'.<sup>13</sup> In a nutshell, 'individualization is becoming *the social structure of second modern society itself*'.<sup>14</sup>

As structural powers recede, social determinism diminishes and the scope for individual decision-making increases: 'Individualization in this sense means that each person's biography is removed from given determinations and placed in his or her own hands'.<sup>15</sup> However, the paradox of Beck and Beck-Gernsheim's *agential* portrait is that increased individualization is *not* accompanied by increased individuation. There is no growth in real personal differentiation, and thus in the heterogeneity of the population.

Both structures and agents are characterised by such indeterminacy that they can have no determinate consequences for one another. As far as structure is concerned, it is not seriously allowed that different groupings of agents face truly different objective 'circumstances', which they take into account, under their own descriptions, in the process of their subjective decision-making. Instead, their circumstances (not of their making or choosing) are levelled out.<sup>16</sup> For example, extremes of poverty and wealth are deprived of significance by the observation that, for the majority, their

<sup>12</sup> *Ibid.*, p. 14.

<sup>13</sup> *Ibid.*, p. 51.

<sup>14</sup> Authors' 'Preface', *Individualization*, *Ibid.*, p. XXII.

<sup>15</sup> *Risk Society*, *Ibid.*, p. 135.

<sup>16</sup> *Individualization*, *Ibid.*, p. 49-51.

positions on society's wealth distribution are not durable but are readily transposed a few years later. Thus, social inequality becomes 'ambivalent' rather than influencing different courses of action. A general, homogeneous feeling of anxiety is held to replace the *heterogeneous* strategies by which differently placed groups and collectivities once sought to advance themselves or to protect their life-chances.

To Beck and Beck-Gernsheim, personal biography is discontinuous in nature. It is subject to breakdown, re-constitution and re-invention. Its only continuity is not one of underlying and enduring concerns but of the narrative form imposed upon it by the fickle and non-binding 'decisions' of its narrator. In other words, their social being is ultimately an ideational self-construct rather than a seat of action. The active agent is dispersed into and conflated with his or her risky environment; at most, he becomes *provisional man* and she is *pro tem* woman. However, although every life is lived electively, because (revisable) choices are made in the opacity and uncertainty of modern society, 'the self-focused individual is hardly in a position to take the unavoidable decisions *in a rational and responsible manner*, that is, with reference to the possible consequences'.<sup>17</sup> The decisions taken become uninteresting because they are *given* all the interest of people playing the lottery.

1.4. The common denominator of the three 'models of man' briefly reviewed is that all are foreigners to the notion of the dignity of every human being. No such claim has ever been made for *homo economicus*, since where is the dignity in systematically following one's self interest (preference schedule)? To David Hume,<sup>18</sup> our 'passions' are given and rule, reason acting as their ingenious servant who is incapable of deeming them to be unworthy. Thus, the most that this 'being' could be accorded is practical worth on utilitarian grounds. Importantly, Adam Smith held that instrumental rationality had to be supplemented by moral sentiments<sup>19</sup> of empathetic benevolence before this 'being' could be regarded as fully human. *Homo sociologicus* has no greater claim to dignity. If 'he' occupies his role competently, in accordance with the rule book, 'he' too may have practical worth – as a functionary. Moral worth cannot be assigned to

<sup>17</sup> *Individualization, Ibid.*, p. 48 (my italics).

<sup>18</sup> 'Reason alone can never be a motive to any action of the will...reason is and ought only to be the slave of the passions and can never pretend to any other office than to serve and obey them', David Hume, *Treatise on Human Nature*, Oxford University Press [1740] 1978, Book II, Part III, Section 3.

<sup>19</sup> Adam Smith, 1984 [1759], *The Theory of Moral Sentiments*, Indianapolis, Liberty Fund.

someone whose only claim is 'to be doing his job' or 'following orders' and this is now explicitly rejected in law as a defence for actions such as war crimes: some jobs just should not be done. The 'serially re-invented man' of late modernity has forfeited in advance any possibility of laying claim to human dignity since he lacks the necessary continuity (as a self rather than an organism) even to lodge it.

In other words, all three models are at variance with the foundational principle of Catholic Social Doctrine, the inalienable dignity of every human being. Upon what basis does the dignity of each and every person rest? This is the single most important question to ask and to answer in any social epoch. Without it being asked and answered satisfactorily, *any kind of social practice can be condoned*: infanticide, child sacrifice, slavery, torture, genocide, ethnic cleansing, exploitation, oppression, subordination, discrimination and exclusion. Such practices merely have to be 'advantageous' in the eyes of those sufficiently powerful to impose them. Over time they may become entrenched as local custom and practice, requiring a major social upheaval before they can be questioned.

In this pervasive individualism-without-dignity is found one contextual and powerfully motivating cause for the recession. What bonds or bounds restrain the ingenious pursuit of monetary gain or the quest for credit unrelated to credit-worthiness? Undoubtedly, in this context the poor pay most and understand least. Yet, the poor themselves used to be the models of thrift. The earliest Friendly Societies – forerunners of the Co-Operative movement – developed to avoid a 'pauper's funeral' or burdening kin with the responsibility of paying for the burial.

The Catholic Church has consistently based its defence of human dignity four-square upon each and every human being made in the image of God. Through this divine filiation each and every one has an inviolable worth and dignity. In the history of thought, no secular answer has been forthcoming that establishes the claim of every human being – regardless of their abilities, attainments or contributions – to be treated as possessing worth and dignity.

On the contrary, secular attempts to provide a rationale for human dignity all fail in fundamental ways. To insist upon our individual 'uniqueness' only begs the question. Why should that grant anyone the respect of others? Today, the way to establish that each person is unique is to take their DNA profile. But what we can derive from that is merely that we are non-identical organic parcels. Although this can be beneficial, for example, in prosecuting the guilty and exonerating the innocent during criminal pro-

ceedings, at the end of the day, uniqueness is just uniqueness. It confers no general right to be treated with dignity.

Similarly, secular Humanism is 'anthropocentric' because it places humankind at the centre of the universe. It draws an opposition between an externally existing world and human subjects distinguished by their possession of consciousness. This has two major limitations. On the one hand, it is a standpoint that makes 'Man the Master of Nature', entitled to 'subdue' it in any manner deemed useful to the human race or some group within it. In according such 'rights' to the human species, it does so by withdrawing all considerations of worth – other than human utility – from the rest of creation: from non-human animals, from the environment, and from the planet itself. Yet, 'Man' is not 'the measure of all things' if 'he' is licensed to destroy the natural environment upon which 'his' fellows and succeeding generations depend. On the other hand, there is nothing in those beneficial effects of this 'mastery' to ensure that fellow humans share in such benefits, let alone that they are shared fairly between them.

Secular sociology has proved a signal failure in even *staking* a claim for the dignity of human beings. Either what are (rightly) underlined are human capacities for suffering and thriving,<sup>20</sup> but animals can suffer too and 'thriving' is usually so narrowly defined as having our organic needs met that it melts into 'surviving', which is compatible with a multitude of assaults upon human dignity. Alternatively, to select a single capacity that can at least be defended as exclusive to human beings – as Richard Rorty<sup>21</sup> does with our susceptibility to 'humiliation' – begs the question of why that rather than other 'subject referring' properties, as Charles Taylor<sup>22</sup> terms them, should be singled out. In my opinion, a better Taylorian case could be made for our human capacity (and need) for 'friendship', as distinct from herd behaviour, since by definition to call someone a friend is to recognise each as a Thou, including disreputable friends. Yet friendship has never featured with importance on the sociological agenda.

This is where 'human rights' come in precisely because, in secular thought, there is nothing in being a member of the human family that auto-

<sup>20</sup> Andrew Sayer, *Why Things Matter: Social Science, Value and Ethical Life*, Cambridge, Cambridge University Press, 2010 (forthcoming).

<sup>21</sup> Richard Rorty, 1989, *Contingency, Irony and Solidarity*, Cambridge, Cambridge University Press, pp. 91-2.

<sup>22</sup> Charles Taylor, 1985, *Human Agency and Language*, Cambridge, Cambridge University Press, p. 54f.

matically accords dignity in society, given the tendency in every age to restrict the enjoyment of crucial 'rights' to elites of various kinds.<sup>23</sup> It is unsurprising that the individualism of the three above models of being human was reflected in the first generation of thought about rights. The 1948 Declaration undoubtedly gave important protection to people on an individual basis. The proclamation of new 'rights' today corresponds more closely to the claims of organized minorities than to the requirements for the human thriving of all. Often, these merely reflect the ethical relativism of a (temporary) political majority, one whose non-universality is best illustrated in the United States where certain 'rights' are upheld in one State but refused in adjacent ones. Again, this should be unsurprising given that secular thinking cannot anchor them in the dignity of human beings.

However much secular goodwill promotes their further extension, what the human rights approach cannot do is to prescribe the legal conditions for the realization of the common good. Although it can penalize racist acts and public abuse, it cannot legislate racial harmony let alone fraternity into being. In short, the long arm of the law cannot stretch far enough over the gap separating human beings, conceived of as a collection of individuals, and the social conditions that are required for universal human thriving.

## 2. HOW THESE INDIVIDUALISTIC MODELS SHAPED THE POLITICS OF MODERNITY

2.1. The corresponding political philosophies were well captured by the slogan of the French Revolutionaries – *Liberté, Égalité, Fraternité*. What is of abiding interest is that 'fraternity' quickly dropped off the agenda and, in Europe, was never re-inserted on it. But, it is *fraternité* which encapsulates the Catholic 'model' of what it is to be human and the social, economic and political institutions that represent the 'common good' for humankind.

Instead, the subsequent politico-economic history of Western Europe had as its *leitmotif* the opposition between the institutionalization of liber-

<sup>23</sup> The Church welcomes the extension of those rights that reflect the dignity of the human person. Thus, in relation to the United Nations' 1948 Declaration, Benedict XVI commended the fact that 'Our society has rightly enshrined the greatness and dignity of the human person in various declarations of rights, formulated in the wake of the Universal Declaration of Human Rights, which was adopted exactly sixty years ago' (Address to the Diplomatic Corps, 7th January, 2008). These are welcomed because they uphold human dignity and hence can be seen as 'common goods'.

ty' or of 'equality',<sup>24</sup> with their nascent political parties lining up accordingly. The hallmarks of Liberalism were the free-Market and non-interventionist State, whose lineaments were still prominent in parties of the right throughout the twentieth century. Those of egalitarianism, as represented by the old Labour Parties, were their opposites – State intervention in the interests of re-distributive justice. Politics were thought of and conducted in dichotomous terms, represented by 'right' versus 'left', with precious little in the middle or at a tangent to this continuum. What never featured on the scene was a 'politics of fraternity' – *fraternité* had been lost and remained squeezed out between the representatives of the two sides of institutionalized and (relatively) peaceful class struggle.

One strength of Catholic Social Teaching is precisely that it does not begin from the problem of how to link 'the individual and society' through politics because it does not start from any version of individualism. Secular thought, especially after the Enlightenment, did just that and promptly fell into one of two traps depending upon how human nature was viewed and how human interaction was seen as generating the social order.

Firstly, on the Liberal conception, let all individuals pursue their individual self-interest and their unerring knowledge about where their own best interests lay would add up to the 'greatest good of the greatest number' (a conception of the 'total good' which is incompatible with the Common Good, as Zamagni illustrates in his paper). Neo-liberalism is essentially *laissez-faire* and effectively declares with Margaret Thatcher that 'there is no such thing as society'. Secondly and conversely, all illiberal conceptions begin from the basic conception that individual wishes, wants and desires are so hostile to one another that without a strong State to curb the 'war of all against all', life will, indeed, be 'nasty, brutish and short'. Control from above, whether in command economies or polities (or both together), is advanced as the only protection against incorrigible aggression. These starkly defined positions have become moderated throughout the twentieth century into milder 'lib' and 'lab' versions<sup>25</sup> without cutting their roots with individualism (see Donati's paper).

'Lib' politics continued to give unabashed support to neo-liberal economics, going beyond the taming of the Trade Unions to accepting the

<sup>24</sup> Liberty and equality were immediately found impossible to reconcile in practice. In the context of education see M.J.A. de Condorcet, 1792, *Sur l'instruction publique*, Paris.

<sup>25</sup> Pierpaolo Donati, 1983, *Introduzione alla sociologia relazionale*, Franco Angeli, Milan (6th edition 2002) and 1991, *Teoria relazionale della società*, Franco Angeli, Milan.

growth of multi-national corporations and de-regulating foreign exchange dealing by the banks. Moreover, the market model was also upheld as without equal for delivering efficiency in such crucial institutions as education, health care, and the social services. But efficiency is not value free; it depends in 'lib' thinking upon competition and choice, both of which are hostile to the second component of Catholic Social Doctrine, namely 'solidarity'. This hostility results from the foundational concept of the human being on which neo-liberalism is grounded: we are all held to be bargain hunters seeking to maximise our individual preferences in the market for health or the market for schooling. We are customers or clients out for the best deal and thus are in competition with other parents or sick people for a school place or a hospital bed. There is no solidarity between us because we are presumed to be – or encouraged and induced to become – *homo economicus*.

'Lab' politics continued to rely upon State intervention, increasingly under the guise of its 'more acceptable face', namely bureaucratic regulation. In a pre-recession 'affluent society', excellence for all became the new clarion call and 'stakeholders' and 'shareholders' the new version of citizens. Yet, 'excellence' was not a value-free term because it was defined by the government's own 'performance indicators'. With the growing deficit in social solidarity, few traditional professional groups resisted their imposition. Indeed, since funding depended upon 'performance', many professionals (such as academics who had little clout) could not roll over fast enough to satisfy changing national regulations.

However, tight bureaucratic regulation is hostile to the third principle of Catholic Social doctrine, that of Subsidiarity. The standardization involved in meeting centrally defined 'performance indicators' deters or distorts provisions – in child care, schooling, health, and care for the aged – which independent, voluntary, or mutual providers attempt to supply. Again, such incursions are ultimately reliant upon a conception of the human being at variance with that of Social Doctrine. Our human *relationships* lose both their spontaneous and civil character and cease to have human content (unlike the traditional image of the family doctor). Instead, we are assumed to be – and can hardly avoid becoming – passive rule followers, occupants of closely prescribed roles, policed by annual reviews, with no gifts to bring unless acquired through in-service training. In short, we become *homo sociologicus*, now known as 'human resources', rather than human beings capable of free-giving and of serving one another through organizations based upon Subsidiarity.

As political centrism intensified in the last decades of the twentieth century, perhaps Europe was about to produce the hat-trick in the form of the first 'lib'/lab' governments generated through compromise and concession, and with little effective dissent except from some regional nationalists and nascent 'greens'. Of particular interest to sociologists was Anthony Giddens' *The Third Way*,<sup>26</sup> although it was not unique in its attempt to 'transcend' right/left politics<sup>27</sup> by a compromise between market capitalism and democratic socialism. It has undergone serious criticisms from both sides and from other claimants to the middle ground.

However, what has not often been signalled is its continuity with the individualism of both 'lib' and 'lab' political philosophies as underlined above. Of course this is called 'the new individualism',<sup>28</sup> but it immediately embraces Ulrich Beck's model of the self-constituted individual, which is quoted at unusual length.<sup>29</sup> His or her recent shedding of tradition merely ends in a further compromise between self-expressive autonomy and necessary contractual obligations – necessary, that is, according to the recent findings of empirical and often empiricist sociology. Thus, for example, 'Marriage and parenthood have always been thought of as tied together, but in the detraditionalized family, where having a child is an altogether different decision from in the past, the two are becoming disentangled. [...] Contractual commitment to a child could thus be separated from marriage, and made by each parent as a binding matter of law'.<sup>30</sup> In other words, individualism should be fostered and the modern Humean passions expressed, except in so far as this requires Hobbesian restraint to prevent harm to other individuals.

What had happened here to the 'politics of fraternity' – precisely nothing at all. What had happened to advocacy of the 'common good' – it had been excluded from the political arena. What had happened to the defence of 'human dignity' – it had become fragmented and contracted into personal rights about single-issues, each of which would be subject to a new social contract.

2.2. Conversely, in the social teaching of the Church, *solidarity* and *subsidiarity* are viewed as linked, mutually reinforcing, and both are necessary

<sup>26</sup> Anthony Giddens, 1998, *The Third Way*, Oxford, Polity Press.

<sup>27</sup> A divide tenaciously defended by Norberto Bobbio, 1996, *Right and Left*, Cambridge, Polity Press.

<sup>28</sup> *Ibid.*, p. 35ff

<sup>29</sup> *Ibid.*, p. 36.

<sup>30</sup> *Ibid.*, p. 95.

for realizing the *common good* in the interests of the *dignity of all human beings* (*Compendium* # 160-163). However, their co-existence cannot be taken for granted. Indeed, the necessary and mutual reinforcement of these two principles – *solidarity* and *subsidiarity* – is threatened today. They do not co-exist because both are being undermined.

On the one hand, there is a diminishing of community-based *solidarity*, of shared values and, thus, of social cement. Everywhere in the developed world, the stable, geo-local and face-to-face community is disintegrating for well-known reasons. Certainly *elective* communities (such as the success of FIFA in football) and *virtual* communities are developing,<sup>31</sup> but the proliferation of social interaction sites (such as Facebook), when used neither maliciously nor ironically, are testaments to loneliness rather than messages to ‘my one thousand friends’.

On the other hand, the invasion of everyday life by market forces (advertising, the easy credit facilities of the immediate past, and the exaggeration of money as the sole currency), together with the intensification of bureaucratic regulations (national and trans-national) mean an enlarged iron cage of bureaucracy imprisons the initiatives of *subsidiarity*.

2.3. In terms of creating a context free from those systemic fault lines that always threaten instability, the progression of the ‘lib’/‘lab’ formula moved in the diametrically opposite direction. At root, I would say that fault line derived from the contradictory formula: <the financialization of everything + institutionalized individualism>. Let us take the two parts in turn to explain this contradiction. Firstly, ‘the financialization of everything’, including every public service, entails attaching a monetary price to each public ‘good’. It constitutes a dramatic and deliberate colonization of services previously operating at least quasi-independently of the state (from care of the aged, to apprenticeship training, independent schooling, counselling, child minding, alternative medicine etc). Monetary payment was never and is not the sole currency invariably employed by all people.<sup>32</sup>

<sup>31</sup> Michel Bauwens, ‘Par Cum Pari’, in Margaret S. Archer and Pierpaolo Donati (eds.), 2008, *Pursuing the Common Good: How Solidarity and Subsidiarity Can Work Together*, Proceedings of the 14th Plenary Session of the Pontifical Academy of Sciences, Vatican City.

<sup>32</sup> One illustration is provided in Britain during 2010, when two friends, female police officers with young children, were held to be in breach of the law through their mutual (non-monetary) arrangement to care for one another’s children, the two mothers having arranged to work different shifts. The breach consisted in neither being ‘registered child minders’. Eventually, the two friends had their appeal upheld, but how many more were deterred from doing likewise by this event?

Obviously, the financial costs soared, fuelling the need to create more jobs in the public sector, to inflate administrative and supervisory posts, and to increase an incomprehensible plethora of benefits and state welfare allowances. In terms of the guiding 'logic', this was no bad thing. It stimulated overall demand, in part by creating jobs which furnished greater spending power. The snag was that this required ever greater amounts of government spending. This corollary was blatant in Britain. During its most recent term in office, the standard governmental response to any reprehensible failure in public services was an undertaking to throw millions or billions of pounds at it. The final implication was worse. Governments became more and more reliant on the money-making activities of the banking sector for increasing both private and public spending.

Secondly and simultaneously, intensified consumption was a prerequisite for this formula working and it was individualization that made it work. Although we were all brought up on Vance Packard's *The Hidden Persuaders* and no one doubts the powers of manipulated consumerism, nevertheless, there is nothing *intrinsically* individualistic about consumption. A recent analysis of weekly grocery shopping in Spain<sup>33</sup> showed how much reflexive thought and concern went into considering what other family members needed or preferred. Until the 1960s, this was the rule and one not confined to the poor alone. For example, parents would make 'sacrifices' to secure a decent education for their children: 'going without' was a relational virtue.

What has changed? Beyond ever more ingenious and seductive inducements to consume, three things have. Firstly, there is the complete dissociation between consumption and human need or thriving. What do most of us in the West know about Imelda Marcos? Only her insatiable appetite for buying shoes, but this individualizes her sufficiently to make a musical about the otherwise anonymous wife of a deposed dictator. Secondly, the very relationships that once induced self-restraint in the interest of others are now commodified to augment consumption. You *qua* individual are not a good partner, parent, or friend unless you bestow the appropriate and expensive tokens of caring. A couple who were both made redundant in December 2009 were interviewed on BBC Radio 4 and asked what they found to be the worst aspect of being unemployed. Their response was the

<sup>33</sup> Pablo Garcia-Ruiz and Carlos Rodriguez-Lluesma, 'Reflexive consumers: a relational approach to consumption as a social practice', in Margaret S. Archer (ed.), 2010, *Conversations about Reflexivity*, Abingdon, Routledge.

inability to give £2,000 worth of Christmas gifts to their child. Thirdly, only commodities count and other gifts are discounted. One of my Romanian friends asked me what I wanted for my birthday and appeared discomfited by my eventual request for something she had knitted. The scarf duly appeared, but accompanied by a token bottle of designer perfume. Other currencies (time, skill, discrimination, effort and, above all, genuine individuality) have been seriously devalued.

This is what fuels the formula, but there is a sting in the tail. Social integration is extremely low and falling. What the mundane examples above were intended to signal was that the financialization of individual self esteem, as it filters into our closest interpersonal relationships, drives integration still further down. When the personal gift becomes indistinguishable from the Company sweetener, how do you know who cares more? The lesson we are intended to learn is 'you show how much you care by spending more'. But a formula that corrodes authentic free giving is acid rain on the fabric of social integration.

Ultimately systemic mal-integration coupled with disintegrating social integration is an explosion waiting to happen, but in these times of fake individualization without individuation, the Beck-Giddens *homo inconstans* does not create a revolution but contracts a sub-prime mortgage.

### 3. THE ABSENCE OF TRUST AND CONFIDENCE

3.1. Strikingly, the most frequent response of those concerned to avoid repetition of the current crisis, whether secular people or religious authorities, is to exhort a return to the traditional virtues. The irony is that in doing so they seek an individual solution to the problem of individualism. Practising virtue is desirable but its benefits should not be confused with the vulgar Methodological Individualist belief that 'good people make for a good society'. Their reasoning is simple enough: since the restoration of trust is essential in the social order, what better way of achieving this than increasing the proportion of trustworthy people? But social organizations do not work in that aggregative way; effective teachers cannot make for effective schooling if the curriculum imposed is literally 'made up' by some power elite – doubtless there were some individuals who were more effective than others at conveying Marxist-Leninism or Soviet history. Above all, in studying any aspect of the social order, micro-, meso- or macro-, the individual is the wrong unit with which to start.

That does not prevent some sociologists also beginning there, as in the following definition: 'I conceptualize trust as a social mechanism which can be explained by people's beliefs and motivations. To trust is to believe that results of somebody's intended action will be appropriate from our point of view'.<sup>34</sup> In this case, the 'social mechanism of trust' is purely additive, like the original meaning of 'horsepower'. Instead, we need to start from at least two people and ask what it is in their relationship that generates mutual (or unilateral) trust. This takes us back to friends, friendship and *fraternité*.

3.2. Most people would readily agree that their good friends are people whom they trust, but that hardly helps because we don't know which way round this works: trust before friendship or vice versa? The same author goes on to talk about 'trust, as a basis for friendship'.<sup>35</sup> This surely cannot be right. Potential friends, say those with whom someone works, can only be observed as trustworthy in a particular context ('he can always be trusted to mark his assignments on time'). Yet he might be an obsessive type rather than trustworthy and, in any case, is that observation really a recommendation for friendship? It seems to me that the process of creating trust works exactly the opposite way around and rather slowly. A dyad may progress from acquaintanceship, through friendliness, to early friendship (or simply stop at one point for all sorts of reasons), but trust is what they generate between themselves later down the time line. It is an emergent property of their relationship, enjoyed by both but, like their friendship itself, belonging to neither since it is a relational good. We do not earn it as two individuals but rather we create it and sustain it together.

Friendship illustrates that our natural sociality stands opposed to any notion of self-sufficient individualism. Instead, our relationships become constitutive of whom we are. Hence it makes no sense to ask why we would do something involving an effort for our friends (children, or parents). This is an end in itself, an expression of our gratitude that they exist, an unconditional assent to the value of the Other's being and, above all, an affirmation of the value of the emergent *relational order* itself – through which, with which and in which we realize ourselves. The effort made is a means to nothing beyond itself, unlike the corporate gift designed to promote further commercial exchanges. Instead, human appreciation of friendship leads us to mint our own non-convertible currencies of love, trust and concern, ones that are indis-

<sup>34</sup> Barbara A. Misztal, 1996, *Trust in Modern Societies*, Cambridge, Polity Press. pp. 2-3.

<sup>35</sup> *Ibid.*, p. 176.

pensable to human thriving yet are entirely alien to the market exchange of equivalents or to the constrained extraction of goods and services.

In parenthesis, it seems a real gap in our theological language that it has no word for the love-that-is-friendship, which exceeds *agape*, can exceed marriage (in Georg Simmel's words through its capacity to 'connect a whole person with another person in its entirety'),<sup>36</sup> and recommends itself as the inclusive paradigm since almost everyone has friends. The theology of friendship, stretching back to Aristotle and Aquinas, seems to have reached its climactic in the teachings of Aelred de Rievault who speculated that God relates to us in friendship, as close friends become 'one soul in two bodies'. John Henry Newman echoed this notion in the epitaph he wrote for the tombstone shared with his friend: 'Ex umbris et imaginibus in veritatem'. Thereafter, close friendship appears to have come under unwarranted suspicion.

3.3. The opposite of individualism is not collectivism but fraternity. Catholic Social Thought is gradually articulating the latter as an alternative basis upon which to conceptualize larger scale forms of sociality than the 'self-interest' and 'necessary constraint' that have dominated the political, economic and social philosophies of Modernity because of their individualism. Interpersonal trust, confidence and concern are the foundations of the functioning of the good society and are precisely what John Paul II termed 'social love' (*Redemptor Hominis* no. 16). This is the source of 'solidarity' and 'subsidiarity' alike, both of which are beyond the wits and repertoire of *homo economicus* and *homo sociologicus*, let alone *homo inconstantus*. Solidarity arises from those actions of reciprocal protection, care and trust of one human being towards another and vice versa because these seek to preserve the worth that the pair generates relationally. Subsidiarity ultimately derives from placing their *munera* at the service of one another, in order to foster their relational goods in a manner that no one else can do. It is the consequence of this emergent property being completely dependent upon the on-going relationship between those involved. And the realization of the 'Common good' depends upon expanding networks of *relations* until they are fully inclusive – meaning that trust and concern are generated at every level until they become the true cement of society.

This is what was articulated by Benedict XVI as the 'civilization of love' (*Caritas in Veritate* no. 33), based upon his recognition of the human being

<sup>36</sup> G. Simmel, 1950, *The Sociology of Georg Simmel* (K.H. Wolf ed.), New York, Free Press, p. 325.

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as someone whose very being is *fundamentally relational*: 'Life in its true sense...is a relationship' (*Spe Salvi* no. 27). How we may envisage getting from the micro-level of friendship to the macro-level of societal fraternity, which is the most important question to answer in order to transcend the crisis that is Modernity, I am going to leave to the next speaker, my friend, Pierpaolo Donati.

# THE CRISIS OF THE 'WORLD SYSTEM' AND THE NEED FOR A NEW CIVIL SOCIETY

PIERPAOLO DONATI

## 1. WHAT IS BEHIND THE WORLD ECONOMY'S CRISIS? THERE IS A PROBLEMATIC AND OBSOLETE VIEW OF THE 'WORLD SYSTEM'

1.1. The financial economy's crisis that broke out in September 2008 has been interpreted in many different ways, mostly from a strictly economic point of view. Basically, the crisis has been attributed to a 'malfunctioning' of financial markets, obviously widely resorting in the process to moral considerations concerning economic actors failing to behave ethically. Solutions have been looking to identify new rules capable of moralising markets.

Politics has been assigned the task to find practical solutions, that is measures implemented by national States and formulated by international agreements among States. International monetary authorities have been called upon by governments to act as fire brigades (i.e. to bail out banks and financial agencies from bankruptcy). Governments have adopted measures to limit the crisis' effects on unemployment as well as an increase in national poverty rates.

We are still short of a sociological interpretation of the crisis per se, differing from interpretations centred upon economic, moral and political factors. Sociological analyses have often been confused with moral ones. Take, for instance, the proposals regarding a new economy with a 'human face', drawing economic behaviour from anthropology (in particular from a personalistic anthropology rooted in both Catholic and Islamic thought).<sup>1</sup>

<sup>1</sup> It is certainly remarkable that Catholic anthropology has been associated with the Islamic Ummah on the grounds that Islamic finance is reported to use money only as a means and not as a goal, which would explain why Islamic financial institutions were able

Such philosophical proposals fall short of making the link between anthropology and economics by considering the specifically social factors that are the subject of sociology.

In fact, the interpretations that have shown how the crisis was determined by a lack of ethics in the economy have also shown that ethics on its own – i.e. seen as a call upon economic actors to act according to moral principles – can do very little, not to say nothing. It has been observed that only political coercion can introduce rules into the economy, whose ethical quality is always debatable. Instances of ethical self-regulation on the part of economic actors and financial markets have been rare in for-profit sectors. This in turn has highlighted to an even greater extent the weakness of the ethics-economy match as a remedy for the crisis.

In my view, we need a sociological analysis to show how the crisis stemmed from a certain setup of the so-called 'global society'. Such a setup is the product of a long historical development, which goes beyond the financial crisis' outbreak in 2008.

The question we ask is the following: from a sociological standpoint, why did this crisis break out? And what remedies can be put in place?

Luhmann's sociological analysis turns out to be very useful to understand the situation in question. Luhmann (1984) holds that highly modernised societies act as a *world system* (a *world society*) of a functional kind, in which each sub-system, for instance the economic one, is self-referential and autopoietic. The financialisation of the economy has emerged precisely out of that (Luhmann 1998). This means that in Western societal systems, representing the paradigmatic model of modernisation processes for the rest of the world, political power can enforce some limitations to economic systems. These limitations, however, are only contingent, merely functional and they cannot meet normative imperatives beyond economic and political action. Ethics is turned into an *exaggerated steering mania*, which proves to be practically ineffective when challenged by real incidents (Luhmann 1997a: 50).

In other words, it is clear that modernised societies cannot resort to any solid moral values, least of all to a *business ethics*, simply because this goes against the modernisation idea itself. Modernised societies are constructed

to avoid being crushed by the world crisis of September 2008 (cf. Riccardo Milano, *Finanza islamica e finanza etica. Il denaro al servizio dell'uomo*, in [newsletter@benecomune.net](mailto:newsletter@benecomune.net), 11 February 2010).

in such a way as to be immunised from ethics. As Luhmann put it bluntly and brutally (1984 [1990: 354]), ‘man is no longer the yardstick of society’.

I am not going to expound Luhmann’s theory here: I will have to take it as known. I will get straight to the point: the thing is that sociological theory nowadays converges on the idea that world society is bound to face a future bristling with risks, uncertainties, disorientation, and even chaos (in the technical sense of the word). A future which, as Luhmann put it, *cannot* even *begin*. ‘Reflexive modernisation’ theory (Beck, Giddens and Lash 1994), though with different emphases, has in essence legitimised such an analysis of the current situation and of future prospects.

What, then, is/lies behind the world financial crisis started in 2008? There is certainly a very different crisis from that of 1929. The historical circumstances are totally different. At the time capitalism was scarcely regulated and lacked a substantial welfare State structure. Nowadays markets are far more regulated and benefit from more developed social security systems.

As national States play a much larger part than eighty years ago, the measures that have now been put in place to solve the crisis amount to three kinds of action: (i) incentives to, and enforcement of market best practices by political-administrative systems, (ii) ban on ‘dirty’ financial products and on fiscal heavens, and (iii) greater public commitment in terms of social expenditure, to nurture the real economy’s virtuous cycles (by supporting family expenses, by limiting unemployment damages, by protecting poorer segments of the population).

And yet is that the solution? Personally, I doubt it. My analysis, then, proposes an interpretation of the crisis and of its solutions that is different from the most widespread ones.

The measures adopted these days cannot solve the crisis, but, for a number of reasons, they can at most provide temporary stoppers and remedies.

First of all, all these remedies remain within the ‘economic-political system’, which would confirm Luhmann’s arguments by which the market+ State system will keep on working even during a constant endemic crisis (I call it *lib-lab* configuration).<sup>2</sup> My argument, then, is that if we want to avoid a permanent crisis – more or less ‘under control’ as the case may be – then remedies have to break away from the self-referential logic of economic-political systems. In Luhmann’s conceptual framework this is not possible. We

<sup>2</sup> I have described and analysed the *lib-lab* setup in many works I simply have to refer to here: cf. Donati (2000, 2001, 2009).

then have to accept the challenge posed by having to prove that an alternative societal setup is not only abstractly possible, but is also necessary and realistic, if we really want to get out of a system producing a chronic crisis.

Secondly, the ethics that is called upon to correct the market's malfunctioning has no credible sociological foundations, for the ethical principles one would like to uphold have nowhere to be generated or regenerated in this societal configuration, since neither the market nor the State are sources of ethical standards. If ethical corrections are to work, one needs to think of a different way of organising society. Such a new setup: (i) has to be capable of allowing for the emergence of social subjects (viz. 'social environments' for the economic and political system) that can generate and adopt certain ethical standards of conduct and uphold them in economic-political systems, and (ii) has to meet such a condition in a structural manner and not by way of an occasional voluntary commitment. Luhmann would say that this is not possible, because – in his view – society's multiple spheres cannot in any way influence one another, least of all exchange ethical services. I propose to meet the challenge of proving that this is as possible as it is necessary, if we want to avoid a permanent crisis.

1.2. My argument, of a sociological kind, is that *the setup of world society is a critical and unstable setup it is impossible to get out of except by reforming its own lib-lab basic structure*. Let me explain this.

Societies that have been or are in the process of being modernised are based on a structural (systemic) compromise between Market (*lib*) and State (*lab*). By 'Market' I mean free competition and capitalistic production theories and practices that refer to liberalism as an economic doctrine (it is the *lib* side, on which we find, for instance, the Chicago school). By 'State', I mean the State intervention theories and practices, aimed at guaranteeing equal opportunities and a welfare bare minimum as a citizenship right, which is generally supported by socialist-oriented political doctrines (it is the *lab* side, on which we find, for instance, the doctrines going back to J.M. Keynes, Lord Beveridge, R. Titmuss).

In brief, modernised systems are a mix of *lib* and *lab*, that is *lib-lab* systems. Whenever the market (*lib*) is insolvent, one resorts to the State (*lab*); whenever the State (*lab*) is insolvent, one resorts to the market (*lib*). This is the game of modern economy, which attained its most accomplished model in the second half of the twentieth century.

Our societies are still working on the basis of this framework, looking to stabilise economic cycles and a fairer resource distribution through *lib-lab* regulations.

What is wrong with this societal configuration?

On the one hand, it is to be said that the *lib-lab* setup has so far offered remarkable advantages, in as much as it has guaranteed freedom and more extensive political and social citizenship rights. In fact, we can say about this setup what is said about liberal democracies, i.e. that although this system is full of defects, it is the best one human history has produced so far. On the other hand, though, we have to point out that its structural faults are not insignificant, but they concern some mechanisms which produce intrinsically and inevitably recurrent crises. In other words, *lib-lab systems are not sustainable as long-term systems*.

What are the mechanisms that make this society unsustainable? I would like to analyse the problematic aspects of *lib-lab* systems and verify whether there can be a societal configuration that can overcome these limitations.

1.3. Let us first look at intrinsic faults of the *lib-lab* setup.<sup>3</sup>

a) According to the *lib-lab* approach, *society is an intertwining of economics and politics against which the rest is seen as insignificant for the common good and for citizenship*. In particular, life worlds are conceived as a merely 'private' sphere. I myself would rather point out that, from a sociological point of view, what lies outside the State-market pair is not insignificant for the achievement of the common good, for citizenship and for the workings of both market and State. If life worlds are conceived as 'left overs', the *lib-lab* system falls into a chronic crisis it cannot remedy.

b) For the *lib-lab* system, *there is no alternative to the combination of liberalism and socialism*.<sup>4</sup> Such a societal configuration, though, essentially considered as a problem of *balancing* between (anti-systemic) freedom and equality (in view of extending individual freedoms), refrains from tackling the *social integration* problems<sup>5</sup> posed by such an approach. Even though one may agree that society's systemic planning is not a workable regulatory response, still it is clear that the *lib-lab* combination says almost nothing on social integration problems in contemporary social systems. To put it

<sup>3</sup> For a more detailed analysis cf. Donati (2000: 229-260), Donati (2001: 202-227).

<sup>4</sup> A champion of this approach, Ralph Dahrendorf (1994) sees citizenship as a gift granted (*octroyée*) by an enlightened political élite, including entitlements guaranteed by the State versus other provisions offered by the free market.

<sup>5</sup> I am using the phrase 'social integration' here to distinguish it from 'systemic integration' (Lockwood 1992, 1999).

another way, *lib-lab* systems generate increasing social integration deficits (the so-called 'modernity pathologies')<sup>6</sup> for which they provide no remedies.

c) The *lib-lab* setup seeks to tame the 'competition-profit vs. solidarity-social redistribution' conflict without providing alternatives to the permanent opposition between these two contradictory needs. The conflict is seen and dealt with as an insoluble opposition, which may only be kept under control through political democracy, especially in the form of neo-corporativistic democracy. The two oppositions, though, bring about a structural imbalance. In the USA, the competition-profit side has the upper hand over social citizenship rights, which entails serious social inequality and poverty indexes in Third World contexts. In Europe the solidarity-redistribution side prevails on the basis of a citizenship principle that seeks to be unconditional without actually succeeding in that.

The *world system* (or globalisation), marked by the economy's financialisation, is the outcome of this current worldwide societal *lib-lab* structure.

The recurrent crises are not those predicted by Karl Marx. The polarisation process setting the leading world imperialist bourgeoisie against the proletarian masses does not occur on a worldwide scale, but in limited geopolitical-economic areas, where it is restrained by *lib-lab* systems, looking, despite all their shortcomings, to reduce social inequalities. Furthermore, globalisation gives rise to many other intermediary economic actors between the two poles envisaged by Marx.

What determines the crises occurring in systems based on the *lib-lab* compromise between State and market is the very 'economic logic',<sup>7</sup> which is not purely capitalistic, but is based on the intertwining of market and State, and thus embraces society as a whole (starting with the market). Such an economic logic has unexpected effects, side effects and negative external effects which erode the civil society on which the *lib-lab* system is based. What is this logic about?

Let me summarise it in Figure 1. The economic logic I am talking about consists in using political power to increase consumption, which in turn will foster productivity and profits, so as to be able to draw on fiscal drag for the financial resources needed to push consumption. The rest is irrelevant. Banks and financial systems serve this logic.

<sup>6</sup> The well-known expression was first proposed by J. Habermas (1981), who deals with such pathologies in terms of communicative forms and not as a more complex problem. At the cultural level it has been employed by Charles Taylor.

<sup>7</sup> The term 'economic' here is used in an analytical generalised sense: cfr. Donati (1991; chapter 4).

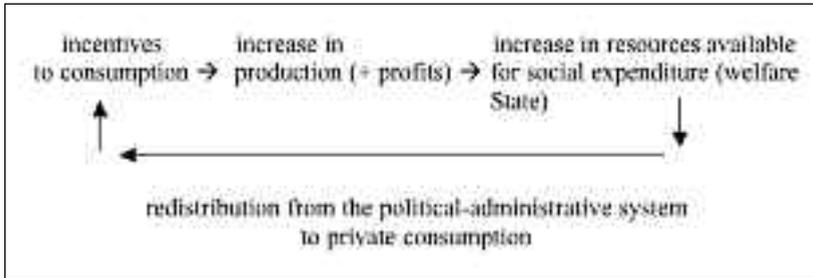


Figure 1. *Lib-lab* systems' economic logic (an evolutionary model which is supposed to bring us to 'progress').

Such a systemic logic, with all its internal mechanisms, cannot be extended over certain thresholds, because great social problems arise once certain economic growth levels are exceeded. The present societal model proves functional to break away from poverty and under-development, whereas it becomes dysfunctional for a welfare society. In particular:

a. Consumerism generates a broad range of problematic or pathological human conditions since consumption needs are artificially induced and technologies, especially the media, are misused;

b. The social inclusion model that is supported by this logic (founded on a simple extension of the typical twentieth-century welfare State) makes beneficiaries ever more passive and produces distorted effects: for instance, it creates various 'traps' (the poverty trap, the 'crystal roof' limiting women's social mobility and distorting equal opportunities on the basis of gender, etc.), and above all immunises individuals from social relations.

Many will point out that there are no alternatives to the systemic logic I am talking about (Figure 1) because: a) if you curb consumption, you also stop economic growth; b) if you cut social expenditure (the welfare State), you create poverty.

What shall we do then?

The proposals put forward are centred on introducing two kinds of correcting tools:

(1) Putting *more ethics into the market*, as proposed by some, in the hope of making actors more responsible:<sup>8</sup> two examples of this are 'business ethics'

<sup>8</sup> On the issue of finance ethics see Ettore Gotti Tedeschi, *Denaro e Paradiso* [Money and Heaven], Edizioni Piemme, Casale Monferrato, 2005 and Id., *Spiriti Animalì. La concorrenza giusta* [Animal Spirits. Fair Competition], Università Bocconi Editore, Milano, 2007.

at the production stage and a 'fairness ethics' in the distribution of goods – such proposals are especially aimed at correcting the *lib* side of this setup.

(2) Extending citizenship, as proposed by others, to make it 'more inclusive' to embrace the weakest social segments, in order to reduce poverty and social problems – such proposals are especially aimed at correcting the *lab* side of this setup.

I note that such corrective measures do not modify the systemic logic of *lib-lab* systems. As generous as the above proposals may be, they do not stand many chances of succeeding. They do not stand many chances of succeeding because it is the *lib-lab* system itself which makes them ineffective. The system continues to work in such a way as to be functional to a moral order centred upon individual, instrumental and utilitarian values and criteria. Though sensitive to the need for personal honesty and greater social justice (in the form of equal opportunities), these values and criteria fail to meet the need to create a civil society capable of supporting honest and fair behaviour. On the whole, it is a self-contradictory model, because it is the economy that drives morality and not viceversa.<sup>9</sup> We have to modify the *lib-lab* logic. I shall now attempt to present these arguments in more detail.

## 2. SHOULD WE YIELD TO EVOLUTION LAWS?

2.1. The *lib-lab* view of the *world system* urges us to let society run in accordance with its own evolutionary tendencies. Such an approach is implemented through a so-called 'reflexive' modernisation model, which in essence chronically questions itself. As Beck, Bonss and Lau (2003: 3) put it, "Reflexive" does *not* mean that people today lead a more conscious life. On the contrary, "reflexive" does not signify an "increase in mastery and consciousness, but a heightened awareness that mastery is impossible". Simple modernity becomes "reflexive modernization" to the extent that it disenchantments and then dissolves its own taken-for-granted premises'. This leaves the referent, the purpose and the point of 'reflexivity' highly ambiguous.

The society envisaged by the *lib-lab* way of thinking is a society which suffers from a permanent identity crisis, pervaded as it is by insoluble social and personal risks. Reflexive modernisation is seen as a radical uncertainty affecting every sphere of social life.<sup>10</sup>

<sup>9</sup> In the AGIL terms the Adaptation function prevails on the Latency function.

<sup>10</sup> On a critique of the reflexive modernisation theory: cf. Archer (2007), Donati (2010a).

According to my argument, on the basis of modernity's own assumptions, the abovementioned correcting measures (i.e. a. ethical injections into the market and b. extension of citizenship rights and their beneficiaries) do not work because: a. the *lib-lab* logic is relativistic from an ethical point of view and neutralises any attempts to replace economic criteria by 'non-negotiable' ethical criteria; b. the extension of citizenship rights (in terms of more rights and more beneficiaries) is always unstable and problematic, and, at any rate, if it is viewed according to the typical twentieth-century *lib-lab* welfare State model, faces increasing failures (fiscal crises, inclusions generating exclusions, etc.).

In short, the present modernisation processes do not tolerate any restrictive, external regulations of the *lib-lab* logic (in the three stages summarised in Fig. 1: consumption, for profit production and redistribution through the welfare State). The only regulations this logic can endure are functional ones, that is functional to its own reproduction.

Neo-functionalism, though, does not ensure any society capable of avoiding the dilemmas and social pathologies produced by such a societal model. It cannot produce any stable social system, it can only determine the same problems again and again. *Neo-functionalism turns to be just 'another way', only outwardly non-ideological, of describing the commodification of the world and an evolutionary adaptation of the whole society to such commodification processes.*

Basically, the *lib-lab* model proposes us to live in a society that adapts to Darwin's evolutionary laws, lacking any finalism and pushed by its competition and survival skills. This is globalisation's own *world system*.

There seem to be no alternatives to this State of affairs. Utopias have fallen. And yet, perhaps, a careful analysis of the situation may reveal ongoing societal morphogenetic processes which question the functionalistic view of economic rationality as configured in the *lib-lab* model (Figure 1). Sociology has consecrated this model first with Talcott Parsons' theory and later, faced with the former's failure, with Niklas Luhmann's one. We now see a new version in place, which we had better look at: it is a version of functionalism proposing an interpretation of markets, particularly financial ones, through key 'reflexive truths' (Soros 2000).

2.2. George Soros, the international magnate, has pointed out that financial markets' workings follow their own 'reflexivity' (or reflexive rationality) marked by evolutionary mechanisms, which are self-referential and have uncertain outcomes. These 'mechanisms' are rooted in the partic-

ular reflexivity of economic actors who 'discount' the future. They shape reality (what actually happens in society, not only in markets) through investments that anticipate the future and pre-empt future reality in the shape desired by financial operators. Reality is transformed through the financial operators' own 'reflexive truth'.

However, our question is: to what extent can society – interpreted as daily life's social texture – be configured in the same way as financial markets and their 'reflexive' logic promoting an evolution without finalism? The thing is that society – if we see it as a social relationships network properly – is not a *stock exchange*. There are other types of reflexivity to shape society (Archer 2003, 2007, ed. 2010; Donati 2009, 2010a).

The argument I would like to hold is that it is these 'other' forms of reflexivity that can get us out of the crisis started in 2008 and beyond the *lib-lab* systems' own chronic crisis.

### 3. IS THERE AN ALTERNATIVE TO AN EVOLUTION WITHOUT FINALISM?

Can we think of an alternative to the functionalist and evolutionist model I have been discussing? I think that the world needs a post-functionalist, indeed an *after-modern* development model (Donati 2010b forthcoming), i.e. based on the assumption of definitely overcoming functionalism – theoretical and empirical – as its intellectual infrastructure.<sup>11</sup>

However, a word of caution is needed here. Functionalism cannot be overcome by a backward-looking humanistic view, unable to match the competitive skills of functionalism. It has to be a humanism proving capable of taking functionalism into account while overcoming its limitations.

Such a post-functionalist development configuration or logic ought to be able to do two things:

- a) At a macro level, to reduce systemic determinisms, in favour of organisational networks capable of self-steering;
- b) At a micro-level (i.e. of individual action), to modify lifestyles, i.e. consumption habits, according to more austere value guidelines, to avoid

<sup>11</sup> I take it that modernity corresponds to a society spirit and model of a functional type (as has been clarified very well by Niklas Luhmann's own theory). I see functionalism as the root of the scientific-technological approach typical of the West and of Western modernity, as Davis (1959) described it.

functionalistic commercialisation mechanisms. Life worlds, i.e. primary (face-to-face) relations and interactions, taking place within families, small groups, associations' networks based on interpersonal relations, have to be given a chance to speak. One has to take into account the decisive role of *personal* reflexivity, seen as inner conversation (Archer 2000, 2003) and the role of *social* reflexivity as a quality of relations' networks (Donati 2010b).

It is clear that such changes are not possible within a consumption economy whose only ruling principle is the GNP growth imperative (as it is in Figure 1). They become possible, though, as soon as one takes on board the fact that GNP has been a useful well-being parameter when used for developing countries with quite a low average income and with widespread poverty problems, but it becomes hardly significant for societies that have reached a certain well-being threshold, such as post-industrial countries. In these countries, GNP has to be replaced by other units of measure, such as Gross National Well-Being (GNWB), which should be adopted not only by developed countries, but also by developing countries.

An austere lifestyle does not mean a 'poor' economy that reduces aspirations to a greater well-being. It does not mean, for instance, a mere de-industrialisation or a demise of medical services or schooling as proposed in the past, nor does it mean rejecting technology. It does not mean going back to a naively 'naturalistic' way of life. These are utopias without any hope or sense. A different economy is made possible by a different notion, relational and not merely materialistic, of well-being and of happiness.<sup>12</sup>

We need another economic logic, if we realize the relational character of society which follows from the 'happiness paradox' (according to which the well-being in the advanced countries does not increase over time, or even declines, in spite of the rising trend of income, while people continue to strive for money).

We have to ask ourselves if and how it is possible to envisage an economy centred upon the human quality of individual and social life and focused on humanising social relations.

The crisis that emerged in 2008 is at the root of the following novelties (see Figure 2):

- Consumption habits are becoming more reflexive;
- We are seeing an expansion of an economy that we may call relational because it envisages the economic stages of production-distribution-con-

<sup>12</sup> Cf. Diwan (2000) and Donati (2009).

sumption of goods and services in terms of social relations and aims at producing a synergy between profit and non-profit;

- The rule of the welfare State is gradually replaced by a societal governance (plural and subsidiary welfare, featuring a market-State-third sector triangle);

- Societal governance seeks to operate reflexively both on consumption and on market differentiation (for profit, non profit, civil economy, etc.) in order to produce relational goods.

Such changes point to the rise of another type of societal configuration, as outlined in Figure 2.

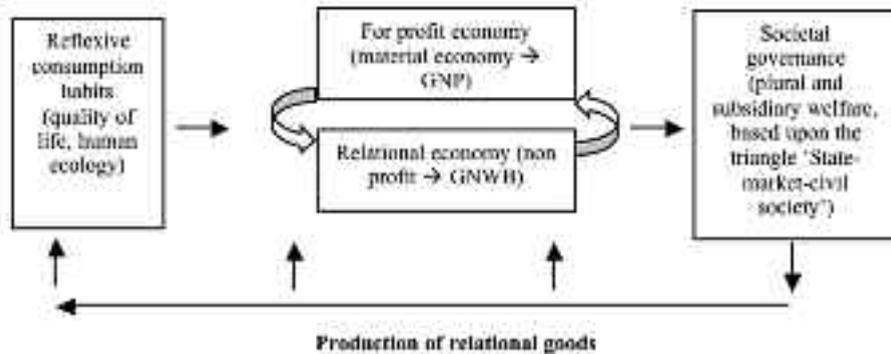


Fig. 2. The economic logic of a relational society.

It is important to emphasise the role of the social spheres commonly called 'third sector'. Not only does the influence of their economic role increase (in terms of turnover and workforce), but above all such spheres operate as an 'engine of a civil society' that is alternative to the market underpinning the *lib-lab* setup (as described in my Figure 1).

It is the vast world of co-operation (social co-operation, social enterprises), of voluntary associations, of ethical banks and of various forms of microcredit, of fair trade, of NGOs, of multiple forms of enterprises which we call 'civil'. Such bodies create their own financial markets, such as the *Bolsa de Valores Sociales y Ambientais* (BVS&A) in Brazil, *SASIX* (*South African Social Investment Exchange*) in South Africa, the *KIVA* project in the USA, the *Asian Impact Investment Exchange* (*IIX*) managed by the

*Social Stock Exchange Asia (SSXA)* in Singapore, *GEXSI (Global Exchange For Social Investment)* in the UK, *MYC4* in Denmark and *Social Stock Exchange Ltd.* in the UK, involving the Rockefeller Foundation, and finally the *FacciaperFaccia* [Face for Face] event at the *Falacosagiusta* fair in Milan. Others have proposed to create a 'social stock exchange', aimed at managing *social and welfare business*, which would become an integral part of a horizontal subsidiary setup a State could not ignore. And this might happen by setting up a sort of AIM (*Alternative Investment Market*), whose financial instruments would be shares (issued by low profit enterprises and non-profit social enterprises) and debt bonds (equally issued by for profit and non profit bodies).

Such new enterprises as *low profit limited liability companies* and *community interest companies*, as well as new financial markets, can produce a different response to the world economic crisis, not merely by adapting themselves but by giving moral standards priority in economic and social action and by being able to modify life, work and consumption styles. Compared with traditional capitalist enterprises, such enterprises have a number of peculiar features: for instance, they produce relational goods (and more generally *intangibile goods*), they show greater flexibility, value side-ways social mobility, rather than upward or downward job mobility.

These new economic entities do convey a new model of society, but to implement it they have to overcome a number of obstacles: (i) internally, they have to develop their own reflexivity; (ii) externally, they have to get rid of their structural dependence on the State (above all in Europe) and on the for-profit market (above all in the USA).<sup>13</sup>

#### 4. RETHINKING CIVIL SOCIETY AND ITS ECONOMIC FOUNDATIONS

4.1. The problem with modernity having reached the globalisation stage is that civil society is still seen as a capitalist economy tending to financialise real economy. The 2008 crisis has revealed this way of seeing civil society and has at the same time started to elaborate a new way of interpreting civil society. In other terms, the 2008 crisis has highlighted the dif-

<sup>13</sup> As an indicator that a *lib-lab* configuration is prevailing in the USA too (and not only in Europe), it can be reminded that 97% of the private debt in the States passes through the State (Sinn 2010: ch. 11).

ference (a real *splitting*) between the old and the new civil society. We may have reached a turning-point between one and the other.

On the one hand, the old civil society is still amongst us, tending to subject every good to the sequence by which money is invested in goods which in turn are used to make more money [Money-Good-Money (M-G-M)]. Actors, that is, invest money in a good they have no need for, but which is only instrumental to making more money. At first, they attribute to that good a monetary (functional) value and then trade it to make more money. It is important to understand that this mechanism presides over the whole *lib-lab* system. The State also uses it in its relationship with the market: the State uses the market to get the money to pay for public welfare, which in turn is the source of votes, the political system's own money. In this context, civil society is identified with the market.

On the other hand, a new civil society has emerged, which is identified with real economy. In real economy, in contrast with the previous case, the good is evaluated in itself and money (also in forms different from currency) is only used by actors as a tool to acquire the goods they need [according to the sequence: Good-Money-Good (G-M-G)]. A good is translated into the money needed to obtain another necessary good (for instance: work provides the money used by actors to buy the goods they want).

Rethinking civil society means understanding whether, and how, it is possible, and necessary in the first place, to shift from the M-G-M sequence to the G-M-G sequence. This shift requires a more complex view of society than modernity's own view. At the core of this view lies the relational nature of goods. Indeed, if it is true that the distinctive feature of a modernising economy is to erase the relational nature of goods and economic processes, the building blocks of a new economy will be precisely the new needs for individual and social relationships. It is not by accident that we see gifts coming back into so many social spheres and in many different forms (Donati 2003): from a sociological point of view, gifts point to the pursuit of social bonds and to the need for social relations to be forged to cement the sense of community.

4.2. Let me explain the distinction I have been drawing between the two societies: the modern one and the one I call after-modern, in more detail (Figure 3).

The key element of this distinction is the fact that after-modern society is confronted with the need to produce a variety pool of options (in goods consumption and production, in lifestyles, in welfare measures) which can-

not be 'accidental', or amount to a merely functional monetary equivalence (as Luhmann holds), but has to be endowed with sense, permitting the creation of common goods, by which I mean relational goods (Donati 2008).

This results in the rise of a new *Zeitgeist*. Whenever we say that future society will have to be inspired by the ethical criterion of 'sustainability', we have many different things in mind, the first being that instruments, such as finance, technology, etc., must match human needs and not viceversa. Which in turn implies that means have to be used only as means and not as self-standing ends or goals.

I summarise the distinction between modern and after-modern setups in a table (Fig. 3).

(i) In modern society:

A) Financial economy is based on the equation: money = currency

G) Money is an end in itself, because of the functional culture which makes all goods and services subjectable to monetary equivalence;

I) Enterprises have no broader social responsibility than that strictly associated with their own employees;

L) The motives of economic action are individual, instrumental, acquisitive.

(ii) In after-modern society, on the other hand:

A) Means economy assumes that money does not only amount to currency, but there can be other forms of money, meaning by money an entitlement to access goods and services [money ≠ currency]. This economy, therefore, draws a distinction between monetary and non-monetary forms of money, by connecting them to 'real economy' (in which many goods and services do not allow for monetary equivalents). Hence arises an observable multiplication of forms of money, labour and capitals (not only financial capital, but also political, social and human) and also a multiplication of contracts, in brief, of all the goods needed to pursue an economic objective (Donati 2001);

G) Money is subjected to social constraints, which may be usage or functional constraints (as, for instance, is the case of vouchers);

I) Corporate social responsibility is extended outside the company to the surrounding community and to stakeholders (profits do not only or entirely go to shareholders); social responsibility is also broadened with regard to employees with forms of conciliation between work and family, with relational contracts, as well as corporate citizenship;

L) The motives of economic action relate individual interests to principles of subsidiarity and solidarity which are necessary to produce common goods, which will be relational goods.

	In a 'Modern' society	In an 'After-modern' society
A (means)	Money = currency	Money $\neq$ currency
G (goals)	The only constraint set by money is for it to provide more money	Functional constraints are set for the use of money (in its various monetary and non-monetary forms)
I (social respons.)	Enterprises only have an internal social responsibility to their employees	Enterprises also have an external responsibility (to the community's stakeholders)
L (values)	Value motives are individualistic, instrumental, acquisitive	Value motives are relational (inspired by subsidiarity and solidarity to produce goods seen as relational goods)

Fig. 3. Two paradigmatic setups of economy.

4.3. The new societal configuration (as outlined in Fig. 4) does not erase modernity, but sees the modern *lib-lab* setup only as a particular case, that is as a way of operating (of organising economy, politics, etc.) which is no longer general and which cannot be generalised throughout all social actors and spheres (i.e. AGIL), but is only applicable to ever more limited action areas. Earlier on modernisation was seen as potentially extendable throughout all spheres of society. This in turn legitimised the fact that the compromise between State and market was able to turn life worlds into commodities. The new setup that I call after-modern is not characterised by a logic of dominance of a pole (market or State) over the other or by commercial negotiation logics between sub-systems or social spheres,<sup>14</sup> but by a *network-like logic* which is forced to make the different societal spheres more co-operative, or at least to follow a mutually non-destructive competition logic, within a world-system's global sustainability project.

<sup>14</sup> I am referring to individual A, G, I, L sub-systems with the institutions thereof.

To implement such a setup, one needs a relational configuration that modernity was unable to tolerate, because it was overwhelmed by cultural movements seeing modernity as a denial of sociality.<sup>15</sup>

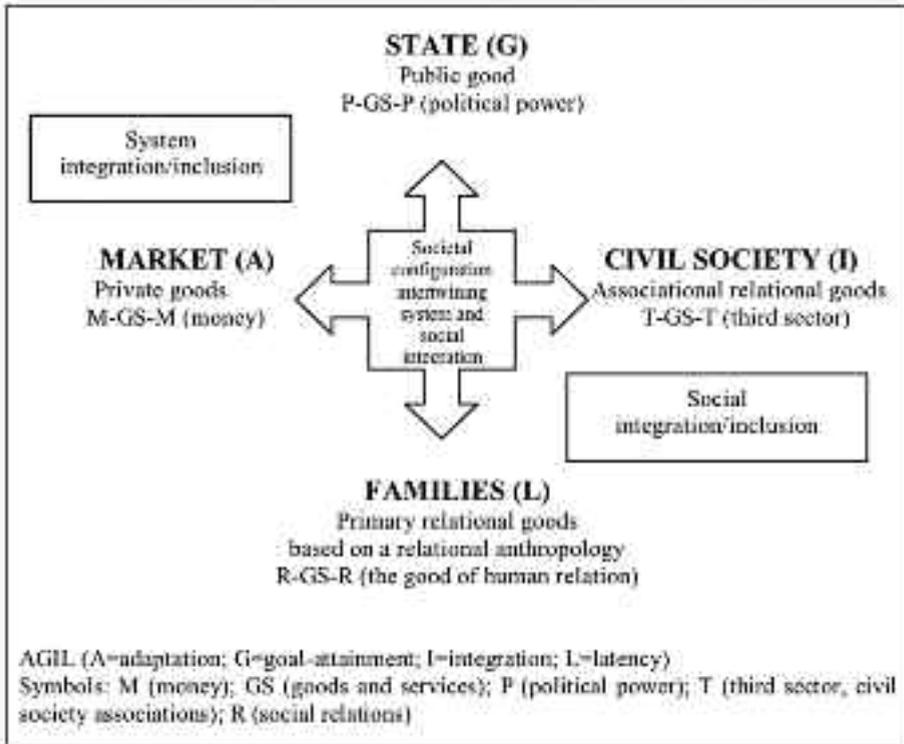


Figure 4. The new configuration of after-modern society.

4.4. The encyclical *Caritas in Veritate*, in my opinion, is to be read and interpreted in this light. I shall make a few remarks on the encyclical, to highlight how this document paves the way for the view of society that I

<sup>15</sup> J.J. Rousseau's works, for instance, provide a paradigmatic example of this position, which has justified an apolitical individualism and at the same time State dictatorships within modernity (cf. Spaemann 2009).

have summarised in Figure 4. We shall thus be able to grasp even better what societal configuration will be functional to getting out of the long-term crisis that broke out in 2008.

*Caritas in Veritate* has been the subject of many comments, both written and oral. These have rightly focused on its central issue, i.e. that charity lived out in truth 'is the principal driving force behind the authentic development of every person and of all humanity' (no. 1). The Pope's call to rediscover the deepest meaning of human actions in the true love of God (who is Truth) and of others certainly lies at the heart of the encyclical. It is undoubtedly the guiding star for the analysis of both complex economic, social and political problems and of their possible solutions.

In the present essay, I would like to underline an aspect of the encyclical which has not yet been discussed in depth. I am referring to the 'way of thinking' Pope Ratzinger proposes in this text. It is a way of thinking which is centred on *relationality* as a central category to interpret human condition and the ways to achieve a full genuine development of the person and of humanity ('Thinking of this kind requires a *deeper critical evaluation of the category of relation*', no. 53).

Pope Ratzinger proclaims that 'charity is at the heart of the Church's social doctrine' with the following justification: as 'it gives real substance to the personal relationship with God and with neighbour; it is the principle not only of micro-relationships (with friends, with family members or within small groups) but also of macro-relationships (social, economic and political ones)' (no. 2). From the very beginning, it is clear that the turning point of the encyclical is found in the quality of relations, micro and macro, through meso-relations (those of civil society's median bodies which are dealt with at length in chapters 3, 4 and 5).

This approach is based on the idea that, while the eternal truth by which human dignity consists in being children of God still holds, it is also true that today there is a change in the sense (historical, cultural and contextual) of what 'human' is. The scenario shows us a range of degradations of every kind, especially in the area of human life and family manipulations, and also presents many emergencies in education, unemployment, denial of fundamental human rights in so many areas of the globe. This new scenario cannot be addressed without an adequate anthropology ('the social question has become a radically anthropological question', no. 75) and without this anthropology being able to cast its light on the whole society, that is on all the social relations in which human life is in question.

In my view, the way Benedict XVI proposes can be called 'relational', given the fact that it is in the category of relation that a solution is to be sought. 'As a spiritual being, the human creature is defined through interpersonal relations. The more authentically he or she lives these relations, the more his or her own personal identity matures. It is not by isolation that human beings establishes his worth, but by placing himself in relation with others and with God. Hence these relations take on fundamental importance. The same holds true for peoples as well. *A metaphysical understanding of the relations between persons is therefore of great benefit for their development*' (no. 53). And a little further: 'The Christian revelation of the unity of the human race presupposes a *metaphysical interpretation of the "humanum" in which relationality is an essential element*' (no. 55).

That is then the *fil rouge* running through the encyclical: interpreting the 'humanum' through relationality and hence moving on to carry out an analysis suited to our times of the various difficult questions we are confronted with.

The quality of social relations is identified with what people love most, the 'ultimate' concerns they express in their relations. Love is a gift of God, but it is also an ultimate concern of human persons. Its presence or its absence justifies the problems we endure and paves the way to their possible solutions. Yet love is not a nice feeling, but rather *a certain relation* with oneself, with neighbours and with God. The encyclical precisely insists on the fact that charity cannot be interpreted as a generic feeling, affection or emotion. The charity discussed here, precisely because it is relation, cannot be a 'private' fact (deprived of social responsibility). It is conversely the source of every good, as a relational good. This is why love can and must become a principle of social organisation (the civilisation of love). '[T]he decisive issue is the overall moral tenor of society' (no. 51). Humans have to 'weave networks of charity' (no. 5). 'The *earthly city* is promoted not merely by relationships of rights and duties, but to an even greater and more fundamental extent by relationships of gratuitousness, mercy and communion. Charity always manifests God's love in human relationships as well' (no. 6).

Hence, then, can be drawn all the operational consequences. In sum: the idea that the relations in which charity is made concrete, such as gifts and fraternity, can and must turn from marginal and marginalised occurrences in modern society into principles occupying a primary place in most practical matters, such as the way of organising and managing economic enterprises, consumer associations, unions, social service networks, the welfare State, the relations among peoples and so on. Right up to support-

ing the articulation of society, the way of 'setting up societies' (associations in the broad sense of the word), based on a *governance* of a societal and plural type, which realises the common good through a solidarity and subsidiarity combination between all society's parts. This holds true from a family organisation right up to international relations.

What, though, can push men and women along this path, given the present globalisation process led by a rampant capitalism, by ever more pervasive individualism, by clear signs of separation and fragmentation of the social fabric?

It is at this point that truth comes into play, so that charity may not be reduced to mere emotions: 'Without truth, charity is confined to a narrow field devoid of relations. It is excluded from the plans and processes of promoting human development of universal range, in dialogue between knowledge and praxis' (no. 4); and again: 'Truth frees charity from the constraints of an emotionalism that deprives it of relational and social content' (no. 3).

Here again emerges the importance of the relational key as a 'novelty' of the encyclical. In fact, beyond well-known issues (call to an integral human development, to fight old and new poverties, etc.), its specific contribution lies in highlighting *the mutual interchange between charity and truth configured as thinking of them 'relationally'*. It is from such relationality that can arise blueprints for a new humanism open to transcendence. There is no truth without charity and there is no charity without truth. Truth needs charity, just like charity needs truth. This *unbreakable link* is the relation that characterises the 'humanum'. In it find their roots all the qualities we may define as authentically human, which are indispensable to achieve a 'society of the "humanum"', that is an economy and politics, a technology, a bioethics with a human face.

The relational link between love and truth is always necessary, but its forms and content are always contingent due to the peculiarities of contexts, in space and time.

The outcome of this new perspective is the development of 'a new vision' (no. 78) which responds to Paul VI's cry: 'the world is in trouble because of the lack of thinking' (no. 53). The encyclical letter *Caritas in Veritate* invites us to embrace a new vision opening up a precise path, which stems from a theological vision, but is able to speak to and fertilise all human and social sciences.

The Church does not claim to provide cookery book recipes, but points to a new way of thinking which has its source in *relationality*, rooted in the simultaneously transcendent and immanent reality of the Trinity. Such a

perspective is particularly voiced as a dialogue with human and social sciences in sections 53-55 (see a comment by Archer 2009), and adds substance to all the other more 'practical' considerations concerning the configuration of economic relations (a new civil economy), of political relation (a new plural, subsidiary, relational welfare), of family relations and life care (a new relational bioethics), and so on.

The deepest message of the encyclical, I believe, lies then in betting on a new ethical interaction between consciences and intellects, on a relational vision, which may be up to the challenge of the new interdependences among individuals and among peoples. Human development will be the emergent effect of this new vision of socialising and of the resulting practices. For instance, it will no longer be feasible to see and practice artificial procreation as an expression of a private desire or (emotional) feeling expressed by one or more individuals, because what matters is the dignity of the relation which bears the child, a dignity on which depends the *humanum* in the identity of the child him/herself. Pope Benedict's call to 'reciprocity of consciences and liberties' is a call to rethink our lives in this direction, that is as a relation in what it has of human. Life is human in so far as it is a 'relational reality' in a specific sense (Donati 2010). From this way of thinking can arise a new society.

In view of this perspective the common good is reinterpreted as a relational good, which can only be achieved by making an appropriate and combined use of the solidarity and subsidiarity principles, on the basis of a relational anthropology and a relational view of society as a whole, starting from the family.

Particularly important is the Statement according to which: 'The exclusively binary model of market-plus-State is corrosive of society, while economic forms based on solidarity, which find their natural home in civil society without being restricted to it, build up society. The market of gratuitousness does not exist, and attitudes of gratuitousness cannot be established by law. Yet both the market and politics need individuals who are open to reciprocal gift' (Benedict XVI 2009, no. 39).

In my sociological language, this means that we have to see social inclusion as relational inclusion and social differentiation as not merely functional but as relational differentiation (Donati 2009).

I therefore propose to interpret the encyclical in a relational perspective enabling us to make it lively and practicable. This means that twenty-first century society has to take a new departure from civil society. Which nowadays entails the fact that the New Deal no longer only rests on the State or

only on the market, or on a combination of the two, but on the network between State, Market and Civil Society (third sector organisations). Such a network is to be observed and implemented therein as a relational network, not as a knot structure (Fig. 4). But surely a decisive role is assigned to relational economy, with its prototypical, though not exclusive expression in the Third Sector, capable of providing ethical inputs to State and Market. Yet, as demonstrated by empirical sociological research (Donati, Tronca 2009), the Third Sector in turn needs inputs to devise a culture capable of upholding goods and services as social relations, rather than as means to make money. Such inputs come from the primary networks of families and of interpersonal relations.

##### 5. IN CONCLUSION: A NEW 'WAY OF MAKING SOCIETY'

The *world system* based on the financialisation not only of economy but, we may well say, of all social relations, experiences a chronic crisis and has to be reconverted. But how?

In the present essay, I have argued that we do not have to resort to an abstract societal 'model', but rather to facilitate some ways of life (forms of a *modus vivendi*), i.e. ways of operating and making society, which may trace the original practices of a civil society that is not subordinate to the compromise between State and market.

It is possible to apply to the paradigmatic civil society a notion of 'reconversion' by analogy with what happened to market reconversion, when we shifted from an economy based on large industrial concerns to the information and knowledge economy. It can be defined as a reconversion of *civil* society if we think of it as a 'bottom up' promotion of networks of social relations which do not respond to imperatives of functional service and to monetary equivalence criteria, but meet the need to create relational goods.

The reconfiguration of civil society according to the scenario I have outlined (Figures 2, 3 & 4) will redefine the ways of being of State and Market as well.

Certainly, present societal configurations are characterised by great disparities between countries. The gap between the two sides of the Atlantic is well-known. In the US the market is typically *lib* and is celebrated as such. In Europe (in the EU), conversely, the market proclaims itself as 'social' and is celebrated as such. In actual fact, though, in both cases the societal model pursued is the *lib-lab* one, as proved by the continuing State and Federal

intervention in the USA (in particular under the Obama administration, even though Ronald Reagan and Bill Clinton had already widely implemented Keynesian policies) and by the increasing practice of resorting to market privatisations (disguised as applications of the subsidiarity principle) in Europe.

My view is that not only Europe and North America, but every Continent needs the new development model I have tried to outline.

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## THE PROCESS OF 'CREATIVE DESTRUCTION' AND SUBSIDIARITY: A RESPONSE TO PROFESSORS ARCHER AND DONATI

RUSSELL HITTINGER

The papers by Archer and Donati invite us to consider once again the principle of subsidiarity. Although we considered this principle only two years ago, let us see what other lessons we can learn from the current economic crisis.

Along with virtually all of the other members of this Academy, I argued at our plenary session two years ago that subsidiarity cannot be properly understood apart from solidarity, provided that one means by solidarity some kind of social union.<sup>1</sup> This admonition was echoed last year in Benedict's encyclical.<sup>2</sup> For my part, I contended that the *principle* of subsidiarity should not be equated with devolution, namely, that subsidiarity requires responsible action at the lowest possible level, or most efficient level. When a government devolves, or defers to actions initiated at the lowest or more efficient levels, its *policies* may be guided by the principle of subsidiarity. Strictly speaking, however, the *principle* of subsidiarity is not a matter of quantity or size. Indeed, the quantitative approach is quite compatible with the premise of methodological individualism – namely, that social unities and relations among members can be reduced to nonsocial properties of members or composites thereof. Margaret Archer's paper brings this out quite nicely.

<sup>1</sup> 'The Coherence of the Four Basic Principles of Catholic Social Doctrine: An Interpretation'. Keynote Address Pontifical Academy of Social Sciences, XIV Plenary Session. Margaret S. Archer and Pierpaolo Donati, eds., *Pursuing the Common Good*. Pontifical Academy of Social Sciences, *Acta* 14 (Città del Vaticano, 2008), 75-123.

<sup>2</sup> *Caritas in veritate* (2009), §57.

On the neo-Epicurean premise that so often prevails in the social sciences,<sup>3</sup> subsidiarity can only mean the demand to achieve efficient aggregations of choice and power. Individual agents, ends, and choices are bundled and unbundled as suit the purpose of a very abstract modeling of economic life. Economic phenomena are depicted in a way completely indifferent to social realities. On this model, if the term means anything, subsidiarity means lowest possible level.

Rather, subsidiarity presupposes a plurality of group-persons having their own ends and forms of union: spouses, families, colleges, churches, cooperatives, municipalities. All such entities engage in exchanges, distributions, and consumption. But if they have their own social principle, they possess at least one thing that cannot be exchanged, distributed, or consumed: viz. the common good. The *praxis* of participating as a member in a common good is different than the *praxis* of making decisions for one's private good.

In Catholic social thought, subsidiarity does not posit or create diverse modes of solidarity; it rather presupposes them. The *principle* is simply stated. First, that societies within the commonwealth deserve assistance from the state. Ordinarily, this means legal recognition of their unions, and the state's unique role of harmonizing relations between the subsidiary societies. In an emergency, help can include a temporary, substitutional role of the state in providing material resources. Second, that in rendering this assistance, the state must not subvert the sociality of the societies being helped.

These two prongs of subsidiarity – *subsidium* and *sub sedeo* – are underscored in *Caritas in veritate*, where Benedict refers to organization that is 'subsidiary and stratified'.<sup>4</sup>

The concept of subsidiarity first made its appearance in the first two books of the *Politics*, where Aristotle gives something like a sociological

<sup>3</sup> [It is] the outcome of a purposeful utilization of a universal law determining cosmic becoming, viz., the higher productivity of the division of labor... [It] consisted in the complete demolition of all metaphysical doctrines concerning the origin and operation of social cooperation. It consummated the spiritual, moral and intellectual emancipation of mankind inaugurated by the philosophy of Epicureanism'. Ludwig von Mises, *Human Action*, 4th rev. edition (San Francisco: Fox & Wilkes), 147.

<sup>4</sup> *Id.*, §57. The typical Latin edition reads, *haec tamen auctoritas subsidiario modo et polyarchico est ordinanda*. The notion of polyarchic is appropriate in the context of this paragraph, which recommends effective international authority. Unless there exist societies completely bereft of authority, to erect international authority that erases other authorities virtually denies the existence of other societies. Such would homogenize social realities from the top down as markets are wont to do from the bottom up. In any case, this is precisely what the principle of subsidiarity forbids.

account of the diversity of societies pre-existing the *polis*. (I remind the reader that the title page of Durkheim's 1893 *De La Division Du Travail Social* quotes Aristotle's Pol. I 1261a 24, that the real unity of the *polis* must include diversity of social elements). The account was both descriptive and normative, for Aristotle intended to counter Plato's conception of an ideal polity that enjoys a socially homogeneous common good. This ideal order, he contended, would destroy marriage, family, and village, along with the other associations which cluster around these social units. Aristotle's sociological observations were turned into a much sharper set of philosophical tools in Thomas Aquinas's *Sententia libri Politicorum*.<sup>5</sup> Here, Thomas did not explicitly use the term subsidiarity, but he does make the bevy of distinctions which will be used by Catholic thinkers in the 19th and 20th centuries: (1) that although polity has a divine-like dignity, it is not socially homogeneous;<sup>6</sup> (2) that the diversity contained in polity cannot be reduced to quantity;<sup>7</sup> (3) that the social components are themselves complex, for even the household consists not merely of distinct functions but distinct modes of union, e.g. spouses, children, servants;<sup>8</sup> (4) that it is necessary to distinguish between a common good (*bonum commune*) and goods commonly pooled (*bona communia*);<sup>9</sup> (5) that a progressive series of unifications within the body politic would produce another individual rather than a society, and in so doing polity would be destroyed;<sup>10</sup> (6) in conclusion of which, we can understand that a polity should *not* have maximum unity.<sup>11</sup>

Aristotle's thinking on social pluralism had far reaching consequences for Thomas. I will mention only two. In his much celebrated treatment of the first precepts of the natural law, Thomas stratifies the precepts in such a way that they reflect man as a rational animal, man as a matrimonial and domestic animal, and man as a political animal.<sup>12</sup> Thus, in microcosm, the

<sup>5</sup> Sancti Thomae de Aquino, *Sententia libri Politicorum*. Textum Leoninum Romae 1971 editum emendatum ac translatum a Roberto Busa S.J. in taenias magneticas denuo recognovit Enrique Alarcón atque instruxit.

<sup>6</sup> *Includit omnes alia communitates*, [79076] *Sententia Pol.*, lib. 1 1.1 n. 3.

<sup>7</sup> *Quia differentia quae est secundum magis et minus no diversificat speciem*, [79079] *Sententia Pol.*, lib. 1.1.1 n. 6.

<sup>8</sup> *Id.*, [79082, et seq. 79097], nos. 9, 11, 17, 19, 24.

<sup>9</sup> *Id.*, [79243] lib. 2.1 n. 10. The point being that a common pool, *bona communia*, is more like an aggregation than a true society. But this does not suggest that true societies having a common good will not have *bona communia* as well.

<sup>10</sup> *Id.*, [79244] lib. 2.1 n. 11.

<sup>11</sup> *Unde patet falsum esse quod Socrates dixit optimum esse in civitate quod sit maxime una*, *Id.*, [79249] lib 2.1 1 n. 16.

<sup>12</sup> S.t. I-II, 94.2.

soul is already poised to participate in various kinds of social membership included in a polity, which is itself a union of social unions. (From a theological perspective, we find here a trace of the Trinity: to be, to live, and to know). This in turn is paralleled by Thomas's threefold scheme of prudence: individual, domestic, and regnative.<sup>13</sup> In effect, Thomas builds the scheme of subsidiarity into the natural law and into the chief practical virtues of human agency.

To make a long story short, these philosophical resources were recovered in the 19th century by Leo XIII and his successors in order to respond to the revolutionary states which aspired to do precisely what Aristotle and Thomas said couldn't be done without destroying both the state and social order. Namely, the ambition to impose a socially homogeneous political order. This is exactly where Leo XIII picked up the argument in his first encyclical *Quod apostolici muneris* (1878). Written against Socialism, Leo was not so much interested in markets or economics as he was in the destruction of social diversity by the state, operating under a certain ideology. Although he does not explicitly use the term subsidiarity, he certainly deployed it in the sense familiar to us. In his first encyclical as well as in his famous *Rerum novarum* (1891) he contended that the State should give assistance to societies formed within the commonwealth, *and* that it must protect their specific modes of union. That it was the myth of the autonomous market that constituted the main problem was only peripherally on Leo's horizon. For the most part, it was the myth of the sovereign state that most worried him.

It was Leo's student, Pius XI, who not only used the exact term subsidiarity, but who also made the principle work with regard both to states and markets. This was a crucial moment that is often overlooked. We recall that it was an economic crisis that triggered the encyclical *Quadragesimo anno* (1931) in which subsidiarity is first explicitly defined in the social magisterium. Here, a very terse summary must suffice. The laissez-faire economy did not regulate itself, but fell into a crisis that threatened to destroy society. The State therefore owes *subsidium*. And this 'assistance' includes more than a safety net; it also involves a duty to rebalance and re-situate the relationship between markets and society. The subtitle, *De ordine sociali christiano instaurando*, is translated misleadingly as 'reconstruction of...'. The verb *instaurare* means to renew (or to restore). This is not an insignificant issue

<sup>13</sup> S.t. II-II, 47.11.

when we turn to the second prong of subsidiarity. Assistance, Pius insists, should not subvert the diversity and sociality of society. Pius was not calling for reconstructing so much as rebalancing or recovering or rehabilitating a plurified social order that is under a twofold threat: on one hand, from the market, on the other from the heavy hand of the State's reaction to the destructive effects of the laissez-faire economic policies. So far as I can determine, this is the first time that the Aristotelian-Thomistic philosophy is used for the purpose of identifying something like a destructive dialectic of market and polity. Neither Thomas nor Aristotle had to worry very much about markets disembedded from social and political orders.

I believe that this double function of the principle – facing both markets and states – is very similar to what Professor Donati means by the lib-lab cycle in the political life of contemporary societies. It also shows an affinity for Karl Polanyi's prophetic and magisterial study, *The Great Transformation* (1944). His thesis is elegantly stated at the beginning of the book:

Our thesis is that the idea of a self-adjusting market implied stark utopia. Such an institution could not exist for any length of time without annihilating the human and natural substance of society; it would have physically destroyed man and transformed his surroundings into a wilderness. Inevitably, society took measures to protect itself, but whatever measures it took it impaired the self-regulation of the market, disorganized industrial life, and thus endangered society in yet another way.<sup>14</sup>

If I correctly understand Polanyi (and my colleague Donati) it is precisely this twofold threat that summons the principle of subsidiarity post 1929. While earlier generations of Catholic thinkers focused upon the problem of the State imposing its monopoly over social order – the post 1789 moment, so to speak – by the time of the pontificate of Pius XI it was clear that the myth of the self-regulated market is also utopian and destructive of social order. Social order includes an economic principle that is distinct from a market. Economic thinking is an aspect of human practical reason that aims to promote and maintain the material well being of the family and other societies. As a deliberate skill, economy requires a ranking of ends and means. Whatever we might make of an 'invisible hand' in a market, there is no such thing as an indeliberate mind in economy, at least not in

<sup>14</sup> Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time*, forward by Joseph E. Stiglitz (Boston: Beacon Press, 1957, 2001), at 4.

the strict sense. This must be underscored lest we confuse the critique of self-regulated markets with economies. The latter are, by definition, self-regulated and cannot be anything other. Hayek himself is quick to make this point. A market might be blissfully ignorant of the moral demands of distribution, but not an economy.

Seemingly anarchical markets tend to trigger administrative responses which might curb the market but which also crowd out the initiatives and resources of non-governmental agents. During the 20th century, governmental responses to bubbles, booms, and busts lead in some nations to totalitarian regimes; but even when governments took a more moderate approach, the social order was never truly restored in the Pisan sense of *instaurare*. The social order was saved, but diminished nonetheless.<sup>15</sup>

Today, we are more familiar with the nanny state which colludes with the market even while trying to regulate it. The main point is that Joseph Schumpeter's notion of the 'creative destruction' of Capitalism – the Shiva like competition that assigns all things under the demon of ignorance – includes more than the economic sphere.<sup>16</sup> Inevitably, it includes the state and the societies within it. The social equilibrium is constantly destroyed or at least impaired – not once, but several times in a generation. In our case, twice within a single decade. Hence, having to appeal to both prongs of the principle of subsidiarity seems to be a permanent state of affairs. We are thrown far beyond the ancient and medieval formulations of the principle.

The two prongs used in tandem indicate that the Catholic understanding of subsidiarity is not designed to assist only one political party or ideology. It cuts both ways precisely because of reality on the ground (what Donati calls *lib-lab*, and Polanyi calls the 'double movement'). It does not favor either right-wing liberal 'efficiency' nor left-wing liberal 'autonomy'. Rather, it favors social pluralism, continually caught in the whiplash of anarchical markets and heavy-handed administrative response. As Benedict observes in his encyclical: 'The exclusively binary model of market-plus-State is corrosive of society, while economic forms based on solidarity, which find their natural home in civil society without being restricted to it, build up society'.<sup>17</sup>

<sup>15</sup> From this point of view, it is not enough to say that the government must protect the market from itself; it's also necessary to say that society must be protected from the steps that government must (or does) take in order to protect society from the market.

<sup>16</sup> Joseph Schumpeter, *Capitalism, Socialism and Democracy* (New York: Harper, 1942 and 1957), Ch. VII.

<sup>17</sup> *Caritas*, §38.

What dismays is the fact that despite an enormous body of literature on the principle of subsidiarity, it has to be explained and re-explained every time there is a crisis. At the Committee for Social Thought at the University of Chicago, Yves Simon took a stab at enunciating the concept very simply in this way: 'To ask this question is like asking whether there is more perfection in life than in lifelessness, in activity rather than in mere instrumentality, in plenitude rather than emptiness. Clearly, a whole is better off if its parts are full of initiative than if they are merely traversed by an energy which never becomes their own'.<sup>18</sup> Simon's rendition of the principle might strike us as a piece of common sense. But it is common sense only within the perspective of being a member in one or more social entities. Take away the view *sub specie societatis*, however, and the principle is apt to look very different. At best, it will be interpreted as the cooperation necessary for maintaining a common pool – to be sure, common pooling is nothing to sniff at, but it is not the same thing as a society.

Later in this session, Professor Zamagni will speak about economic enterprises that no longer see themselves as corporate realities, which is to say as bodies (at least partially) possessing a social end or union transcending commodities being prepared for sale on a market. On this view of the corporation, it may exchange, divide, indeed consume itself because its identity never amounted to anything other than an aggregation intended for private yield. Perhaps we shouldn't be surprised, for corporations of this kind have always been located awkwardly between association for the sake of gain and association for the sake of use and enjoyment. It is more sobering, however, when we find true societies erasing the distinction between gain and use. Marriages, families, colleges, hospitals, charitable organizations, small municipalities, and cooperatives make decisions about things that are exchangeable, distributable, and divisible, but these decisions depend upon a superordinate principle of a common good that cannot be cashed out. To be sure, this good can be lost. When members no longer have the trust or the heart to pursue common ends through a common form or union, the social principle is *lost*. But it is logically and ontologically impossible to divide it.

The current crisis suggests that true societies, having (analogously) a common good, speak one way but act just as though (to paraphrase Donati)

<sup>18</sup> Yves R. Simon, 'Common Good and Common Action', *Review of Politics* 122, n. 2 (April 1960), 202-44; reprinted *The Crisis of Modern Times*, Ed. A. James McAdams (Notre Dame: University of Notre Dame Press, 2007), 419.

they were an adjunct to 'the stock market'. They suppose that their existence depends intrinsically and not only accidentally on divisible things. We only need to follow the trail of the housing bubble and the aggregated pension funds to see that real societies had stretched tinsel-thin the distinction between action for profit and action for membership. In the United States, even our most revered not-for-profit institutions risked everything in market, and when disaster ensued, were willing to cut anyone and anything (including its own ends) to preserve the institution. This is the double movement studied by Polanyi two generations ago, albeit chiefly with regard to the state and the market rather than American universities.

I conclude by coming back around to Professor Archer's observation that in recent social encyclicals, the popes have addressed not only issues of justice but also the question of 'social love'. This is surely right. For although subsidiarity is a principle of harmony and balance, and hence of justice in a 'stratified' society, the common good motif is best considered under the principle of love. Let us consider ourselves as lovers of various things and persons, and let us consider what are the relations of justice. Since this is strongly noted in Benedict XVI's recent contribution to social doctrine, it will not be inappropriate to quote St. Augustine: 'Everything that is not lessened by being imparted, is not, if it be possessed without being communicated, possessed as it ought to be possessed'.<sup>19</sup> The beginning of wisdom, says Augustine, is the ability to distinguish between what is to be used and what can only be enjoyed in the manner of usufruct. The common good is something to be enjoyed; the more shareable, the more common, and therefore the more enjoyable. The principle of subsidiarity fits rather well in this Augustinian notion of *communicationes*, which are nothing other than social bonds.<sup>20</sup>

The principle can be explained from this angle or from other angles. It can be defined sociologically, philosophically, or theologically. I suspect that the problem is not an absence of good thinking and crisp definitions. It is embedded rather in a way of life that chronically obscures in the eyes of the heart (to use a scriptural metaphor) the distinction that Aristotle, Augustine, Thomas, and virtually the entire modern social magisterium thought was pretty clear. Namely, the distinction between an aggregated good, a pooled good that is quasi common but intended ultimately for private yield, and a society.

<sup>19</sup> *De Doctrina Christiana* 1.1.

<sup>20</sup> In Thomas's work, every analogous use of the word *societas* is mirrored by uses of the word *communicatio*: *communicatio oeconomica*, *communicatio spiritualis*, *communi-*

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*catio civilis*, and so forth. The word *communicatio* simply means making something common, one rational agent participating in the life of another. Society, for Thomas, is not a thing, but a communication. Indeed, he quotes Augustine's *De Doctrina Christiana*: 'Everything that is not lessened by being imparted...' in defense of a diversity of religious congregations. *Contra Impugnantes*, I.4. §14 [Leonine] A83 1265-70.

# LA CRISIS FINANCIERA MUNDIAL: CAUSAS Y CONSECUENCIAS. LA DIMENSIÓN MORAL

BELISARIO BETANCUR

## 1. INTRODUCCIÓN – LA GRAN DEPRESIÓN

El presidente filósofo latinoamericano, Marco Fidel Suárez, decía hace casi un siglo en su *Oración a Jesucristo*, que el destino de la humanidad es progresar padeciendo. Tan cierto lo es que de una catástrofe se pasa a una alegría.

Recordemos que el año 2008 y 2009 se vivió la más grande crisis económica internacional desde la *Gran Depresión* de los años treinta del siglo XX.

En efecto, en el año 2009 la producción mundial de bienes y servicios decreció 2.2%; el comercio se contrajo 14.4%; y más de 50 millones de personas perdieron su empleo, según informes de la Oficina Internacional del Trabajo (OIT). El Banco Mundial estima, a su vez, que en el presente año 2010 habrá 64 millones de personas adicionales en la pobreza extrema.

Todos los países y agentes económicos a escala global, resultaron afectados, aún aquellos que manejaron con prudencia sus economías y sus finanzas.

En este escrito se analizan las causas y las consecuencias de la crisis; y se hacen reflexiones sobre la dimensión ética y moral de la situación que empieza a superarse, inspiradas en la Encíclica *Caritas in Veritate*.

## 2. CAUSAS DE LA CRISIS

Es fácil estar de acuerdo con el profesor Joseph Stiglitz, cuando señala en su último libro[1] que para superar la crisis, es indispensable entender sus causas fundamentales.

Algunos analistas la atribuyen a fallas del mercado; otros la atribuyen a fallas de los gobiernos; y otros, en fin, a agentes económicos específicos (banqueros e inversionistas).

- En el primer grupo, hay quienes argumentan que los mercados no asignan bien los recursos y que son intrínsecamente inestables; en su versión más extrema, proponen la nacionalización de los medios de producción y el control estatal de las principales actividades económicas. Este modelo fracasó y condujo a sistemas totalitarios. Otros más moderados, proponen un modelo de economía mixta, con responsabilidades concretas por parte del sector público y del sector privado.
- En el segundo grupo, hay analistas que piensan que la falla esencial es de los gobiernos, por la ausencia de una regulación efectiva de los sistemas financieros en Estados Unidos y otros países de altos ingresos. En algunos casos se puede hablar de ausencia de regulación y en otros de regulación inapropiada, dado que los entes estatales encargados de la supervisión, no entendían la dinámica de las innovaciones financieras.
- Otro aspecto relacionado con el tema, es la excesiva liquidez del sistema financiero internacional. Las tasas de interés en Estados Unidos y Japón, registraron niveles muy bajos entre 2003 y 2007, lo cual estimuló a muchos fondos a buscar rentabilidades más altas en operaciones que resultaron ser de riesgo elevado. Se señala también que la política cambiaria de la China, llevó a desajustes significativos en la economía internacional.
- Un tercer grupo de analistas piensa que la responsabilidad hay que buscarla en personas específicas, que abusaron de la confianza de los inversionistas y llevaron a la quiebra a prestigiosas entidades, al asumir riesgos excesivos; y en varios casos, a operar por fuera de claros principios éticos y morales.

### 3. DIÁLOGOS SABIOS

Tales analistas tienen algo de razón: al fin y al cabo, todo está en todo. Pero existe una causa más profunda, relacionada con la forma como se han venido construyendo los modelos de la teoría económica predominante.

Por ejemplo, hace pocas semanas, el economista latinoamericano Diego Pizano presentó en la *Brookings Institution* de Washington, la versión en inglés de su libro sobre el pensamiento económico contemporáneo[2]. Se

trata de diálogos con algunos de los economistas más creativos del siglo XX, incluyendo a los profesores Friedrich Hayek, Paul Samuelson, John Hicks, Nicolas Kaldor, Joan Robinson y Jan Tinbergen. Aunque cada uno de estos pensadores asumía una posición distinta sobre el grado óptimo de intervención estatal, todos tenían claro que el mercado requiere de una infraestructura legal regulatoria adecuada para operar.

Varios de ellos guardaban un profundo respeto por la tesis de Adam Smith, el padre de la economía moderna, cuando señala que los agentes económicos deben operar dentro de un marco moral riguroso.

En la presentación de su libro, el profesor Pizano hizo énfasis en mejorar la capacidad explicativa de la teoría económica, incorporando agentes con racionalidad parcial, que operen en un mundo caracterizado por la volatilidad y la incertidumbre. Recomendó, también, integrar a la teoría económica elementos de la historia, la psicología, el derecho, la antropología y las neurociencias, como lo han venido haciendo la nueva escuela de la economía institucional y los economistas del comportamiento (*behavioral economics*).

#### 4. LA TURBULENCIA FINANCIERA

Los modelos que suponen que los mercados financieros son totalmente eficientes y que se autorregulan, han mostrado deficiencias en su capacidad de interpretar la realidad. Llevaron al desmonte de la regulación e ignoraron tanto la información asimétrica de que habla el profesor Stiglitz, como la incertidumbre de que hablara Keynes, quien insistía en que hay eventos inciertos que no pueden ser reducidos a probabilidades objetivas.

Si los agentes económicos no son totalmente racionales y si no se puede eliminar la incertidumbre, habrá siempre fluctuaciones dramáticas y ciclos económicos convulsos; habrá episodios de alta turbulencia financiera.

#### 5. EN LAS MEJORES FAMILIAS

La historia de los últimos siglos, valida la afirmación anterior. Lo demuestran, además, Carmen Reinhart, de la Universidad de Maryland, y Kenneth Rogoff, de la Universidad de Harvard[3]. En su monumental obra *This Time is Different*, recogen información relacionada con las crisis financieras de los últimos 800 años.

Tal perspectiva histórica es muy útil para darse cuenta de que las crisis financieras y las moratorias de la deuda, no son fenómeno asociado exclusivamente con América Latina y otros países en desarrollo. Francia, por ejemplo, incumplió ocho veces sus compromisos de deuda externa en sus primeros años como estado-nación. España tuvo siete crisis severas en el siglo XIX e incumplió sus compromisos externos en varias oportunidades. Inglaterra experimentó tres graves crisis financieras con incumplimientos externos entre 1300 y 1600.

## 6. CONSECUENCIAS DE LA CRISIS

La economía mundial ha comenzado ahora a registrar síntomas de recuperación.

En efecto, los organismos multilaterales esperan este año un crecimiento positivo para la mayoría de los países.

Esta tendencia es indudablemente positiva. Sin embargo, la crisis ha dejado consecuencias que se sentirán durante muchos años. El desempleo y la pobreza han aumentado, y se necesitarán varios períodos de crecimiento para recuperar el retroceso.

En este momento no es claro que todos los países puedan cumplir en el año 2015 las metas del milenio de las Naciones Unidas. Es posible que varios países del Asia, de Europa Oriental y de América Latina, logren cumplir algunas de las metas. Pero, al mismo tiempo, varios países (especialmente del Africa) van a quedar rezagados en la reducción de la pobreza y en otros indicadores relacionados con la educación y la salud.

Por otra parte, es claro que la economía mundial enfrenta graves riesgos. En primer término, hay fuerzas proteccionistas que podrían afectar la recuperación dinámica del comercio internacional. En el caso de los países en desarrollo, es urgente relanzar las negociaciones de DOHA que buscaban liberalizar el comercio agrícola mundial. Según estimativos de investigadores del *Instituto de Economía Internacional* de Washington[4], esta ronda implicaría un aumento en la producción mundial de bienes y servicios, superior a 300 mil millones de dólares anuales; y aportaría beneficios significativos para los países en desarrollo.

## 7. EL ANTIEJEMPLO DE GRECIA

El otro frente que está generando ansiedad e incertidumbre, es el tamaño de los desequilibrios fiscales en diversos países. Los gobiernos aumentaron el

gasto público, como medida para hacer frente a la recesión. Tal estímulo fue considerado *necesario* por la mayoría de los economistas. Empero, no todo el gasto se ha asignado a proyectos de alta rentabilidad privada y social.

En este momento es necesario que los países adopten programas de ajuste serios en un marco de mediano y largo plazo. Muchos países tendrán que reducir su nivel de gasto en el día adecuado; y varios tendrán que aumentar impuestos. Estas son medidas impopulares, pero si no se hacen en forma oportuna, se pueden registrar problemas como los experimentados por el reciente antiejempro, Grecia.

## 8. LA PARTICIPACIÓN DEL SUBDESARROLLO

Otro capítulo que genera preocupaciones, es el que toca con el empleo. Millones de personas a lo largo y ancho del globo, no encuentran oportunidades de trabajo productivo. De acuerdo con la OIT, en este momento hay más de 212 millones de personas desempleadas, la cifra más alta en la historia económica mundial.

Esta situación agrava la pobreza y no les permite a tales personas, satisfacer sus necesidades básicas, ni mantener su dignidad. En los países de altos ingresos, existen redes de protección social y seguros de desempleo; en cambio en los países en desarrollo estas redes son más débiles y los desempleados se ven obligados a buscar apoyo entre los miembros de su familia extensa, o en organizaciones de asistencia humanitaria, muchas de ellas vinculadas a la Iglesia Católica.

Para generar más empleos y para apoyar los grupos más vulnerables, los países en desarrollo necesitan crecer, hacer más flexibles sus mercados laborales y mejorar las redes de protección social. Se requiere mayor inversión privada, buenas políticas públicas y un ambiente internacional propicio.

Para ello es indispensable liberalizar el comercio mundial de productos agrícolas y mejorar el acceso de los países en desarrollo a la tecnología y a los mercados de los países de altos ingresos. También es indispensable, ampliar los programas de formación de capital humano y de capacitación. Estos programas deben recibir mayores aportes de la comunidad internacional y de los organismos multilaterales de crédito.

## 9. EL CALENTAMIENTO GLOBAL

Un fenómeno que no es consecuencia directa de la crisis pero que se ha intensificado en forma simultánea, es el relacionado con el calentamiento global.

Se podría decir que las causas de este grave fenómeno tienen que ver con políticas ambientales inadecuadas y con modelos de desarrollo que no son sostenibles. Diversos estudios indican que los principales afectados serán los países en desarrollo, a pesar de que la mayor parte de las emisiones provienen de los países altamente industrializados.

La globalización ha mostrado ser una poderosa fuerza de creación de riqueza; y, bien manejada, puede generar grandes beneficios para los países en desarrollo.

En el caso de la India y de la China más de 300 millones de personas han logrado salir de la pobreza extrema en los últimos 20 años. Si se consigue un proceso de globalización inclusivo, sostenible (desde el punto de vista social, económico y ambiental) y manejado con los intereses de los países en desarrollo en mente, es mucho lo que se puede avanzar.

La comunidad internacional y los organismos multilaterales, tienen que darles mayor participación a los países en desarrollo (en los cuales habita el 80% de la población mundial) en los procesos de decisión y de asignación de recursos.

## 10. LA DOCTRINA SOCIAL DE LA IGLESIA

En su Encíclica *Caritas in Veritate*, Su Santidad Benedicto XVI ha complementado los principios de la Doctrina Social de la Iglesia, que habían sido desarrollados en otras Encíclicas importantes como *Populorum Progressio* y *Veritatis Splendor*. En la nueva Encíclica muestra en forma diáfana como la caridad y el amor son fuerzas extraordinarias para construir un desarrollo humano a escala global, basado en la justicia y el bien común.

Pablo VI afirmó que el subdesarrollo refleja falta de fraternidad entre los hombres y entre los pueblos. Tenía razón. Pongamos como ejemplo el caso del acceso al agua potable a nivel mundial. En este momento 1500 millones de personas en el mundo no tienen acceso a este líquido vital. Para corregir tal situación, la comunidad internacional debe dedicar 30 mil millones de dólares anuales en los próximos 10-15 años. Esta es una cifra significativa pero resulta pequeña a la luz de los programas de estímulo fiscal adoptados por diversos países y que han representado trillones de dólares.

## 11. NORTE INMANENTE

El Papa Benedicto XVI, a su vez, ha reiterado su posición en el sentido de que se requiere fortalecer la relación entre la ética y la economía. Tiene

toda la razón. Como Su Santidad lo ha señalado en forma elocuente, toda decisión tecnológica o económica conlleva una dimensión ética.

La ciencia y la tecnología han mostrado tener la capacidad de ofrecer beneficios a la humanidad. Pero si tales fuerzas no se utilizan dentro de un marco ético y moral, las consecuencias pueden ser devastadoras. Baste con pensar en el potencial destructor que se puede derivar del mal uso de la energía atómica.

Otro aspecto importante de la Encíclica, es el relacionado con el desarrollo de cada persona en un marco de libertad y de responsabilidad moral. La globalización debe apoyar el desarrollo de cada individuo, al igual que el desarrollo de cada país. Esto solo es posible si el proceso está orientado por claros principios éticos y morales.

El imperio de la *ética* debe ser el norte inmanente y permanente de la humanidad.

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# THE IMPACT OF THE GLOBAL RECESSION ON DEVELOPING COUNTRIES

PAULUS ZULU

## 1. INTRODUCTION

In a paper entitled 'Global Economic Recession: Effects and Implications for South Africa at a time of political challenges' Padayachee, a research economist from the University of KwaZulu-Natal suggests that, as a region, Africa has suffered from the downturn and cites the International Monetary Fund (IMF) which has placed growth estimates as having been lowered from 5% in 2008 to 1.7% in April 2009 (Padayachee, V. 2010:1). Africa may not be typical of the developing world with which it shares vital socio-economic features. The globalization of the economy has, however, placed together most developing countries such that, in economic terms, it is safe to generalize. I shall, therefore, use mainly Africa as a point of reference to illustrate how the recession has impacted on the developing economies.

At the Africa Group meeting of 20 March 2009, José Manuel Salazar-Xirinachs, Executive Director, Employment sector of the International Labour Organization (ILO), made two principal predictions with regard to the impact of the global recession. The first was that '2009 is a year in which labour markets around the world will be hit hard'. And the second was that '2009 will be the first year since the Millennium Development Goals were launched in which globally poverty will not be reduced but instead will increase' (ILO Global Crisis Observatory 21 May 2009:1). The two predictions have far reaching consequences for the developing world as it is here that individuals and groups are most vulnerable to the vagaries of the economy. A dramatic decline in the labour markets saturates the informal economy adversely as, contrary to conventional economic wisdom, the informal economy cannot act as a cushion to the formal economy in times of a global recession as the data will show in the following sections of this

paper. Secondly, adverse effects on the informal economy have dire consequences on poverty and consequently on food security.

Theoretically, all other things being equal, the capacity of states to dispense public goods and services is a function of their economic capabilities. Secondly, political stability within the state is a direct outcome of the capacity to dispense public goods and services. The data in the following pages shows that the recession works against the poor in two ways:

- i) The slump in economic activity triggers job losses which in turn impact on the lowly paid in precarious employment; and
- ii) The slump in economic activity reduces the fiscal capacity of the state thus impacting on the pro-poor social programmes.

Besides direct economic effects, the recession has serious negative social consequences. As the Executive Director puts it: 'as the recession bites, poverty reduction unravels and the middle classes worldwide are weakened, the risk is that social and political tensions will multiply' (*ibid.*).

In this paper I shall adopt a two-pronged approach to the impact of the recession on developing countries. The first shall comprise an analysis of the impact on macro level factors such as unemployment, reduced commodity prices, reduced trade, foreign aid, etc.; and the second will be on how these factors impact at the household and individual levels. The macro level data is drawn from meetings, workshops and symposia of the ILO in Africa, while micro-level data comes from a study initiated and led by Women in Informal Employment: Globalization and Organization, and conducted in Latin America, Asia and Africa in 2008 – the *Inclusive Cities Project*.

## 2. MACRO-LEVEL FACTORS

The anatomy of the global recession in developing countries follows a simple logic. Developing countries rely mostly on exporting unprocessed goods, mainly minerals and agricultural produce. Because of reduced financial flows in the developed world, there is a decline in trade leading to reduced demand. This immediately leads to a decline in commodity prices and, in the words of the ILO Global Crisis Observatory, 'reduced liquidity and tightening of credit markets affecting both public and private sectors, reduced flows of remittances, a drop in Foreign Direct Investment (FDI), exchange rate depreciation, and declining flows of Official Development Assistance (ODA)' (*op. cit.* 2). Undoubtedly, it is the developing countries that are at the receiving end in such a situation. What suffers most in this instance are: growth, employment and livelihoods.

## 2.1. *Growth*

At the Preparatory meeting of experts on the First African Decent Work Symposium held in Addis Ababa on 27-28 February 2009, the meeting noted that: 'the financial and economic crisis has put at risk Africa's growth and development prospects. In its latest update of January 28, 2009, the IMF predicts that, as a direct consequence of the global financial crisis, Africa's growth will drop to a low rate of 3.4 percent in 2009' (ILO: Preparatory Meeting of Experts on the First African Decent Work Symposium 2009:2). This was to be against growth figures of 6.2 and 5.2% in 2007 and 2008 respectively. The consequences of shrinking growth would express in increased unemployment, a reduction in the states' capacities to provide social services and almost no social security safety nets as is the case in almost all Sub-Saharan African states; and forcing precariously placed workers into an already large informal economy.

Africa's economic fate, for instance, is closely interlinked into the global economy through five key sectors:

- i) Exports of raw materials from mining and agriculture;
- ii) Exporting human resources which results in remittances from the host to the guest countries;
- iii) Capital inflows through foreign investment and bank loans;
- iv) Earnings from tourism; and
- v) Foreign aid.

The recession affected all the above factors in various ways leading to reduced revenues in all respects.

## 2.2. *Employment*

The meeting highlighted 'cases of company closure, postponed or cancelled investments (mainly in mining, auto finance/banking) and job losses across the continent'. In particular, the meeting noted a loss of 300,000 mining jobs in the Katanga District in the Democratic Republic of the Congo; and 36,500 jobs in the South African auto industry (*ibid.*). The ILO Observatory noted that Zambia had to pay off 3,072 copper miners as a result of the slump (ILO Observatory, *op. cit.*). What exacerbates the impact of job losses in the formal economy is the increase in vulnerable employees (unpaid family workers and own account workers as a share of total employment). The ILO Observatory noted that in Africa the ratio of vulnerable employees had increased by 5 percentage points between 2007 and

2009 pushing the figure up to 81.8 percent. In absolute numbers this represents 28 million persons or an additional 36 million persons earning less than US\$1.25 per day. This translates into 67.2 percent classified as the extreme working poor. This has a severe impact on growth, poverty and job creation. The effect of this crisis is that it has reversed the modest gains that Africa made during the growth period up to 2007. As the ILO Observatory states: 'social policy in Africa has not transitioned from a programme-based logic to a truly integrated view of inclusive-growth with social protection and decent work. And in contrast to Latin America, a number of African countries have less fiscal room to maneuver' (*op. cit.* 4).

### 2.3. *Livelihoods*

There are two ways in which the global recession impacted on the generation of livelihoods in developing countries. The first was a decline in direct investment, and the second was in transfers through tourism and remittances. Activities such as tourism which fall within the small sector suffered as a result of the global recession. For instance, between January and June 2009 the Tanzania Association of Tour Operators reported a drop of between 30 and 50 percent in American and European tourists. In Kenya hotel and bed occupancy declined by between 20 and 30 percent. Another sector that was hit is the NGO sector which relies largely on international donors mostly from Europe and North America. Most NGO work is in the social economy (co-operatives and self-help groups funded from foreign humanitarian aid agencies) and as sources of funding diminished in donor countries, less reached the developing world thus reducing NGO activity. Finally, as the recession hit the developed world most, guest workers were the first to lose jobs and with this, remittances to the home countries fell thus reducing livelihood opportunities.

### 2.4. *Impact on Policy*

In this instance I shall use the example of South Africa. The most developed economy in Africa is that of South Africa. Despite the level of economic development and an advanced social security system, South Africa did not escape the negative impact of the recession. Padayachee states: 'The country's Gross Domestic Product growth dropped to 1.8 percent in the last quarter of 2008, and then plunged to -6.8 percent in the first quarter of 2009, and to -3.2 percent in the second quarter. So the country fell into a technical recession

already at the end of the first quarter of 2009' (Padayachee, V. 2010:4). In addition, '484,000 workers lost their jobs in the third quarter of 2009, the largest number in manufacturing (about 150,000): the total job losses were more than the combined totals of the first two quarters of that year..' (*ibid.*).

Padayachee goes on to draw on policy implications of the recession and selects one of the main pillars of South Africa's post-apartheid restitutive policies – Black Economic Empowerment (BEE) which the country considers as an imperative in the transformation of the economy. BEE deals use money loaned from merchant banks to finance the purchase of shares by blacks from existing companies. As he puts it, 'The lack of finance in the quantum needed for BEE deals creates not only a heavy reliance on the "once empowered", the merchant bankers and others (the real beneficiaries) who just lie below the surface of these deals' (*ibid.* 11). However, what is critical in this instance is that the financial crisis has affected the number and character of deals and thus impacting on the country's social policy, and probably the stability of the social transition. Padayachee contends that a number of companies 'have cut back on dividends' thus 'straining the environment for empowerment deals'. He cites the Financial Mail of April 3, 2009 as saying: 'This creates the danger that the banks that funded the deals will call up the debt, forcing the black investors out of the company'. And continues: 'Industrial conglomerate, Barloworld, offered 10 percent of its shares to black investors at R83.31. But since the recession stock prices decreased by 60 percent and were valued at just R33!' (*ibid.*). The result has been a massive decrease in BEE activity prompting Padayachee to aver that 'South Africa's plan to transfer about 25 percent of the country's wealth to black people by 2017 is increasingly looking like a fantasy' (*op. cit.* 12). In short the South African example demonstrates how the recession could derail government policy thus causing social instability to the political system. In societies already torn by poverty and strife, the consequences could be devastating. But, perhaps policies such as BEE might be limited to resource rich countries and not all African countries have an equity problem where race is the causal variable.

### 3. MICRO-LEVEL FACTORS

The impact of the recession at the household and personal level is best demonstrated in a study carried out by Women in Informal Employment: Globalization and Organizing (WIEGO) in coordination with the *Inclusive*

*Cities Project*. The research was carried out in 10 countries in Africa, Latin America, South and South East Asia on informal workers engaged in street vending, waste picking and home-based work. A total of 164 informal workers participated in the study which used both focus groups and individual interviews as a basis of data collection. Results of the survey demonstrate how the recession impacted on individuals, households and groups.

### 3.1. *Decreased Demand and Consumption*

The study reports that the recession has had a marked impact in low income countries especially on informal workers. Decreased demand resulting from a decline in export trade and direct investment as well as from shrinking commodity prices has caused a slump in both the formal and informal sectors. Inside the poor countries the buying power of local consumers declined thus reducing demand. Retrenched and underemployed workers have had to curb their own consumption. Participants in the study reported a decline in their trade volumes between January and June 2009, with only 10% reporting an increase while 23% maintained that their trade volumes remained the same. The hardest hit was industrial home-based workers producing goods for export (*Inclusive Cities Study* 2009).

### 3.2. *Price Instability and Rising Costs*

The recession brought about an increase in production costs while stifling the selling price of goods produced. The study reveals an increase in the prices of both raw materials and ready-made goods. As most of these constituted inputs in the informal business, informal sector practitioners had thus to absorb these costs against declining selling prices. In addition, utility costs for gas, electricity and transportation rose. The study cites mat producers in Pakistan who had to sell their goods to dealers in a town 30 kilometres away and exported to Iran. First the cost of reed which the producers used as raw material rose, then a rise in fuel prices precipitated an increase in transportation costs. By the end of six months buyers were looking for local producers in an effort to control costs.

Rising production costs against depressed local demand brought about a vicious cycle. Either producers had to increase the selling price against low sales volumes or increase their production and bank on the economies of scale. Where practitioners dealt in non-durable or perishable goods there were few if no options. In a majority of instances practitioners decreased

their selling prices (41%) while almost a third (29%) adjusted their prices upwards while another third (31%) kept their prices the same. With decreased profit margins the only alternative was to increase working hours in order to increase production. This reduced parenting and nurturing tasks thus introducing a negative social dimension to family life.

### 3.3. *Household Level Impacts*

The recession precipitated a rise in commodity prices including food and transportation costs. It is common cause that in poor households an inordinate portion of the budget is spent on food and transport. Respondents in the survey reported a drop in the quantity and quality of household food. This entailed a reduction in the number of meals taken per day from two to one in a period of six months. Others reported sacrificing 'luxury' items such as meat and milk from their meals and substituting them with relatively cheaper items such as eggs and offal or 'guts'. In some instances adults forewent their meals in favour of their children. Some respondents sacrificed items such as leisure and clothing in favour of basics such as children's education, food and shelter.

Within the household the dynamics changed as unemployment shifted the dependency burden to informal workers, mostly women. Almost one in five respondents reported that someone in the household had lost a job since January 2009. The research quotes the South African Quarterly Labour Force Survey detailing that 85 percent of jobs lost between January and June 2009 were in the domestic and informal sectors (p. 19).

### 3.4. *Increased Competition within a Shrinking Market*

The *Inclusive Cities Study* dispels the myth that the nature of the informal economy gives it flexibility to cope with shocks and economic downturns. Respondents in the survey reported that more workers had entered their segment of the informal economy. This observation was more pronounced among street vendors where one in four respondents (85%) reported this, and this was followed by waste pickers (49%). The new entrants were mostly women as greater absolute numbers became engaged in the informal economy against a shrinking market (as unemployment increased together with the cost of living, there was less buying power in the economy); increased competition entailed a substantial decline in per capita revenue among informal workers. In total the recession meant diminishing livelihoods in the informal economy.

Informal workers were caught in a vicious cycle. Increased competition led to declining incomes in all the three segments surveyed. Despite the falling incomes very few of the respondents surveyed had attempted alternative or additional employment. In the survey only a quarter of the respondents reported supplementary sources of income. Understandably, informal work is a last resort when individuals cannot find employment in the formal economy. The informal sector has no security and conditions are generally severe. Faced with no alternatives informal workers resorted to further short term survival strategies. Admittedly, the strategies added more risk and uncertainty. Strategies ranged from decreasing stock or production particularly among street vendors trading in perishable goods, to increasing the number of hours or days at work. These were huge sacrifices given that informal workers have very little leisure time.

#### 4. THE RESPONSE

In this section I shall focus on the South African response for two reasons. The first is that because of its advanced economy in Africa, South Africa has the capacity to respond independently outside of international interventions such as foreign aid and humanitarian grants. The second is that South Africa has developed domestic policies such as the social grant and the Expanded Public Works Programme which enable it to leverage its responses to crises. Also South Africa has an advanced statistical base from which reliable analyses can be performed.

In February 2009 following consultations with the National Economic and Labour Council (NEDLAC), (a social accord between government, labour and business) the government issued a Framework outlining its response to the crisis. The Framework outlined three mechanisms by which government intended to alleviate the effects of the crisis. The first was to minimize job losses, the second was to scale up social welfare programmes and the third was to accelerate access to basic social services such as housing, clean water and sanitation including electrification.

##### 4.1. *Alleviating the Impact of Job Losses*

The Framework urged companies to do everything to avoid job losses and promised tax relief to compliant companies and other measures to rescue companies in distress. The Framework further urged companies to take

advantage of the slow down by accelerating staff training programmes thus investing in their people. Finally the Framework stressed government's determination to consolidate the Expanded Public Works Programme as the engine of job creation. Critics of this aspect of the Framework placed emphasis on the problematics of bringing about any job creation within a capitalist labour market framework. Both Jacobs (2009) and Padayachee (2010) maintain that the government is resolute in its commitment to the concept of 'no distribution before growth' as espoused in the Growth Employment and Redistribution policy (GEAR) and propounded in 1996. Critics of the policy have alleged that it resulted in 'jobless growth' between 1996 and 2007 and was, therefore, woefully lacking in its redistributive commitment. In essence, Gear did create skilled jobs while at the same time causing more unskilled jobs to be lost as investors put profits before humanitarian motives. Because of the nature of the model of job creation proposed in the Framework, Jacobs is skeptical of the capacity of the proposals including the Expanded Public Works Programme to create decent jobs. He claims 'when corporations do decide to invest in a few skilled workers this tends to increase unemployment rather than reduce working hours for the sake of sustainable expansion of decent jobs' (*Review of African Political Economy* 2009: 616).

#### 4.2. *Scaling Up Social Welfare Programmes*

South Africa has a well-developed social safety net starting with a universal means tested old age and disability pension, a free health service for pregnant mothers and children under six, an unemployment insurance system and a child support grant for indigent children under sixteen. Jacobs states: 'It is estimated that at least 12 million South Africans (or 25 percent of the population) receive social grants with the number of beneficiaries steadily increasing over the last decade' (*ibid.*). It is also common cause that these grants reach the poorest households and, at times, comprise the sole source of livelihoods. When considering that effective unemployment stands at 32 percent of the economically active age cohort or 5,598,400 in absolute numbers, as a relief measure the social grant is not insignificant. However given the size of the social grant against growing inflation, it is necessary to appraise the plight of the poor within a more complex holistic context. Also, there are competing appraisals of the impact of the social grant in the overall economy. Citing neo-classical labour economists, Jacobs alludes to their claim that 'social welfare grants pegged at high lev-

els discourage the unemployed from seeking work and cultivate dependency on the state' (*ibid.*).

#### 4.3. *Expanding Access to Basic Social Services*

Even much earlier than the onset of the recession South Africa already had a policy of giving rations of free water and electricity to poor households. However, as soon as these households exhaust their free quota, they pay for their consumption, like everybody, on the basis of the charges prescribed by private companies that control the reticulation networks. While in principle government is committed to a policy of universal access to portable water, clean sanitation, housing and electricity, this goal is far from accomplishment. The failure to achieve this has resulted in violent protest action reminiscent of the apartheid days. Part of this cause is the extremely inefficient and corrupt local government system. In the past three years a number of municipalities were declared dysfunctional and some placed under curatorship. This is, therefore, an aspect of the Framework that will need strong political goodwill to accomplish.

#### 4.4. *Other Measures*

Padayachee lists additional measures effected by the South African Reserve Bank to alleviate the financial crisis. These include: 'using moral suasion to get the banks to tighten their lending criteria, while letting credit to flow; further improving banking regulations and supervision, while avoiding the dangers of over regulation; and successively lowering gradually the repo rate (so influencing onward lending rates' (Padayachee, *op. cit.* 13).

### 5. CONCLUSION

While the global recession did not change relations between north and south, it definitely postponed the opportunity of the south to reduce their dependency upon the developed countries. The period from the beginning of the millennium to the onset of the recession has been the epoch of unprecedented growth in the third world and notably in Africa where dependency on international aid is high. The World Bank reported that Africa's growth in 2009 would drop by 66% from the 2007 figures, whereas before the recession it was around 6 and 7%. In addition, the healthy

growth was 'complemented by the emergence of Africa as a vocal political actor, promoting regional and continental integration, active conflict resolution and in governance, for example, the African Peer Review Mechanism' (ILO Conference on the Social Economy 19-21 October, 2009:3). These are gains that the recession has offset and my take long to recover.

Secondly the recession has hit labour markets hard and particularly the vulnerable groups and informal workers. Significant job losses especially within the unskilled and precariously employed ranks drove large numbers into the informal labour market thus exacerbating conditions within an already fragile sector. The extreme working poor increased significantly as dependency ratios increased with an increase in job losses, household incomes dropped resulting in decreased food intake. Remedial measures only added to the lot of the poor as informal workers resorted to working longer hours and increasing production against decreasing prices. Predictably, women bore the brunt of the recession.

Thirdly, developing economies are characterized by huge disparities between rich and poor. The recession might have deepened these disparities thus widening the social schisms and providing grounds for relative deprivation and the consequent social unrest. Already in South Africa protest action has intensified since the beginning of 2009 and is currently on the increase. The last six months have witnessed marked protest against poor delivery of services in the townships often accompanied by violent confrontation between protesters and the security forces. Where states have even less capacity to offer social services, and less political legitimacy, conditions might even be worse and could easily culminate in uncontrolled chaos. Zimbabwe's example of the outbreak of the cholera epidemic in mid 2009 is a case in point. The danger is that such conditions might easily spread across the region.

Finally, on a positive note, observers suggest that while the recession admittedly had a severe economic impact on the continent; this was limited to resource rich countries in Sub-Saharan Africa. The African Development Bank wrote in January 2010: 'It appears that resource-rich countries in Sub-Saharan Africa suffered the largest setback. In contrast, resource poor, landlocked countries have weathered the global downturn relatively well, and are expected to record the highest rates of growth on the continent in 2009' (African Development Bank January 12, 2009:2).

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## WHERE DO WE STAND? THE IMPACT OF THE CRISIS ON PERSONS AND INSTITUTIONS

LUIS ERNESTO DERBEZ BAUTISTA

Let me start by congratulating Professors Betancur and Zulu on their very impressive papers. Both describe in excellent manner the effects of the 2009 global financial crisis over developing nations. In particular I would like to congratulate them for their review on how poor nations addressed the cut in financial flows to their economies, as well as on the specific details on how the people of the countries reacted to their income losses as the crisis took hold of their economies.

Professor Zulu puts his emphasis on the major consequences brought about by the crisis over developing nations in Africa. In a vivid narration, his evaluation shows how the political interface between fragile democracies (like many are in developing countries) and negative economic impacts can destabilize many nations. In particular, it is sad to learn how the global crisis seems to be unraveling South Africa's Black Economic Empowerment Program (BEE); a program designed to mainstreaming low income population into the market economy of that nation after the end of *apartheid*.

Professor Betancur emphasizes the derailing of the Millennium Goals. He makes it clear that as a result of the global financial crisis, 2010 may be the first year of this decade in which the poverty reduction objectives established by the United Nations may not be reached in many developing countries. More importantly, though, his paper explains why we need to define new regulatory frameworks for financial markets if we wish to avoid a repetition of the crisis. And while making his point, he shows that to obtain the full benefits of a market oriented economy, governments need to minimize the negative aspects of the 'normal human behavior' in those markets.<sup>1</sup>

<sup>1</sup> The definition in inverted commas is mine and should not be attributed to Mr. Betancur.

I fully enjoyed Professor Zulu's discussion on the five elements which will affect growth and development in Africa for many years to come. He carefully evaluates the impact that the 2009 crisis will have over: (i) exports of raw materials from mining and agriculture; (ii) exporting human resources which results in remittances from the host to the guest countries; (iii) capital inflows through foreign investment and bank loans; (iv) earnings from tourism; and (v) foreign official aid.

The severe loss of income reported by the studies quoted in his paper makes it evident that it will take a long time to reverse the loss of income suffered by most of the population working in Africa's agriculture and manufacturing industries linked to external trade. Although he does not explicitly make the point, his analysis leads one to conclude that developed nations will have to define programs to compensate African nations for the negative impact brought about by the irresponsible way in which they behaved in international financial markets.

If there is to be a just compensation for the suffering imposed on developing nations by the 'irrational behavior' of developed nations, strong increases in official financial aid, trade preferences and programs supporting the entrepreneurs of African nations must be the response of developed nations for at least the coming decade. Indeed, as the global economy recovers, Professor Zulu's paper shows that it is incumbent upon developed nations to fortify the recovery in developing nations by providing at the very least official financial aid in an amount equivalent to the costs extracted to these nations by the global crisis of 2009.

Professor Betancur's paper makes it clear that implementation of this solution is highly improbable. Despite the unfairness of the current economic situation, and the moral obligation of developed nations to reverse the damage caused to developing nations, his evaluation of the 'Greek effect' shows why the solution currently applied by European nations to deal with the problems faced by Greece, will become a major impediment for such foreign policy to be applied by developed countries. If the response to Greece's crisis is an example of the generosity of developed nations, one has to be too optimistic not to forecast a very depressing future for the world as a whole, and for developing nations in particular.

The 'Greek solution' may become the benchmark against which foreign aid policies will be measured by developed nations; not a good omen for the cause of justice and fair income distribution in the coming years. As Greece demonstrates, most developed nations have grown impervious to other countries suffering; a trend which if continued will go against the recom-

mentations made by His Holiness and many other world leaders concerned about fairness and justice in today's world.

And yet, the costs paid by developing nations are already gigantic. As mentioned by Prof. Zulu in his paper during 2009:

the impact of job losses in the formal economy is the increase in vulnerable employees (unpaid family workers and own account workers as a share of total employment). The ILO Observatory noted that in Africa the ratio of vulnerable employees had increased by 5 percentage points between 2007 and 2009 pushing the figure up to 81.8 percent. In absolute numbers this represents 28 million persons or an additional 36 million persons earning less than US\$1.25 per day. This translates into 67.2 percent classified as the extreme working poor. This has a severe impact on growth, poverty and job creation.<sup>2</sup>

One can only guess the suffering that fiscal adjustment policies demanded today from Greece could have if applied in developing nations. That is why it is imperative to send a strong message to all nations and multilateral institutions against such requirements to provide developing nations with trade preferences or financial aid in the coming years. *Caritas in Veritate seems like a far away possibility at the moment.*

*Yet there is a glimmer of hope if,* as Professor Zulu writes, 'Africa may not be typical of the developing world with which it shares vital socio-economic features'. A recent report<sup>3</sup> of the UN's Economic Commission for Latin America (ECLA) shows that, although the economic crisis put an end to six years of growth in that region, the lessons of the past were put to good use during the global crisis. Lack of inflation, sound financial systems and fiscal leeway built up by past experience cushioned the negative effects of the crisis in many of the countries of the region. Instead of tightening spending, privatizing social services and deregulating the labor market, the region kept up social spending, expanded investment in social services infrastructure. If the Latin American countries had responded to this crisis with the type of fiscal adjustments shown in Prof. Zulu's description of Africa, the social impact would have been much harsher than the effects seen today. *There is a lesson to be learnt in this for other developing nations.*

Nevertheless, as Professors Betancur and Zulu make clear, the poverty issues brought about by the crisis need to be dealt with social policies

<sup>2</sup> Prof. Zulu's paper, p. 4.

<sup>3</sup> ECLAC, *Social Panorama of Latin America*, Santiago, Chile, 2009.

which will ameliorate the current situation faced by many of the poorest families in developing nations. Heavy negative impacts on education and social care programs need to be redressed, if we wish to provide a better future to the people of developing countries in the coming years since, as Professor Zulu mentions in his paper, 'some respondents sacrificed items such as leisure and clothing in favor of basics such as children's education, food and shelter'.<sup>4</sup>

To get a stronger view of what developing nations are facing today, let me provide these facts extracted from the latest World Bank Global Development Report.<sup>5</sup> According to this report, by the end of 2009, 89 more million more people were living in extreme poverty on less than \$1.25 a day, and the global recession had put at risk \$11.6 billion of core spending in areas such as education, health, infrastructure and social protection in the most vulnerable of the developing countries. Moreover after three months of global recovery, an estimated 43 low-income developing countries were still suffering the consequences of the global recession, highlighting the need to increase support to the poorest countries dealing with economic volatility and crisis. The question then becomes, how can we ensure that developing nations provide quality education and social care to their citizens? If the answer to this question is incorrect, the long term effects of the 2009 crisis will be felt for many years to come in those countries.

In their papers, Professors Betancur and Zulu seem partial to government-led and morally-led responses. In my opinion neither of these are the optimal solutions for the problems faced by developing nations today. If we want to ensure that these nations integrate successfully into the global economy in the remainder of this century, we may need to recommend an incentive system for those nations which produces the adequate combination of government intervention, market operation and national entrepreneurs which will provide the required innovation-based growth that will lead to fair income distribution in those nations.

In particular, the incentive system we should propose must respond to the three generally accepted normative principles in the literature of social protection: (i) greater equality in access to services among people of differing resource levels who need care; (ii) universal and needs-based services and benefits; and (iii) intergenerational solidarity. All these principles must

<sup>4</sup> Prof. Zulu's paper, p. 8.

<sup>5</sup> World Bank, *Global Development Report*, Washington, D.C., USA, 2009.

be enshrined in the countries' respective education and social protection systems, according to their measurement of risk profiles, the place attributed to family and policy and the type of welfare regime instituted.

Such a framework can only emerge from a discussion which differentiates between the short term responses applied in 2009 by many developing nations, and those required for their long term successful integration into the global economy. Thus, whereas as mentioned in both papers the actions taken by many developing nations to reduce job losses in the economy, to scale up welfare programs and to accelerate access to social basic services may look as the right actions for the emergency of 2009, if maintained they will stifle the entrepreneurial class in a way that will make it impossible for those nations to successfully confront the globalization process of the 21st century. A government which believes that its role is to provide goods and services for its population, control markets and create monopolistic industries to provide employment, and generate a closed environment for social and educational delivery, will be a government which will condemn its population to a long term path of impoverishment, to a non-democratic system and to emigrate to obtain jobs in other countries.

Thus, although I agree with most of the papers general content, conclusions and recommendations, after reading the papers I became concerned that many of the current wisdom emerging in developing nations about the role that entrepreneurs, markets and governments should play may be going in the wrong direction.

For example, Professor Zulu does not explore in depth the possible consequences of a disappearing entrepreneurial class in South Africa after the crisis; *a point that in my opinion deserves further exploration in discussions between Academicians.*

#### *A successful integration into the global economy demands entrepreneurs*

As developing nations continue their global integration, they will need local entrepreneurs to lead their way into such integration. Too much government intervention would stifle the advent of such a group of people.

Despite his provocative thoughts about the effects of the financial crisis in market behavior and regulations required, Professor Betancur does not address the need to keep markets as the major institution for allocating goods and resources in developing nations. *Despite the well documented failure of international financial markets, there is no better instrument to assign resources in most economies today.* Markets need regulation; there is no

doubt about it. The recent developments demonstrated that there is no such thing as a truly competitive market when the government renounces to its regulatory role. Such a provision of a competition policy must be one of the key elements of future government empowerment in developing nations.

*But more than anything else, markets need competition*

Contrary to what today is taking place in many of these countries, the need for competition should not translate as a government-led economic recovery program with public enterprises and excessive spending as the policy prescription to reach economic growth and income distribution. Such is the danger faced today by developing nations: a return to old practices where the role of the government is interpreted as provider of jobs, participant in the allocation of resources in the economy and defender of monopolistic behavior under the disguise of fair income distribution and protection of the country's sovereignty. Regulation does not mean control. Control does not mean fair income distribution.

*Government policies are not neutral in the redistribution of wealth and the protection of special interest groups in society*

Although the response to the 2009 emergency might have been correct, most of the economic policies applied by governments in developing nations are clearly unsustainable in fiscal terms in the long run. Continuation of these policies would only lead to inflation, fiscal and balance of payments disequilibrium, and loss of economic competitiveness for domestic enterprises. It is thus imperative to change the role of the State towards one where it will act as regulator of markets rather than as savior of the people.

Moreover, few of the poorest countries will have the fiscal space to respond to the economic dislocation caused by the crisis without significant additional financial assistance. It is estimated that IDA countries will require an additional \$35 billion to \$50 billion in funding just to maintain current levels of programming, let alone come up with the additional funding required to meet the needs of those additional individuals thrown into poverty. That is why within the complex layout of responses applied during the global crisis, those provided by the State (through policies that touched on the economy and social redistribution policies) could have long term negative impacts on the solutions worked out within families, those sourced from the market and those crafted through community action in developing nations.

*Finally, political stability cannot be the direct outcome of the capacity of the State to dispense public goods and services in the economy*

Great uncertainty continues to surround future prospects in many developing nations. Even the weak recovery outlined by many international agencies for 2010 is not certain in many of those nations. If the private sector does not become the building block for a strong middle class, it is entirely possible – especially as the impact of fiscal disequilibrium and inflation takes its toll – that those countries will relapse unto undemocratic systems where dictators present themselves as saviors of the people to undo the political progress achieved up to this point in many of those countries.

That would be the saddest consequence of the global crisis; one that most of us did not predict at the start of the new millennium.

# FINANCIAL CRISES AND THE WORLD'S POOR\*

PARTHA DASGUPTA\*\*

## 1. SUMMARY EVIDENCE

The world's poor had no part to play in the pattern of behaviour that precipitated the financial crisis in rich countries during 2007-2008. An extended period of unsustainable credit expansion had gained momentum in the rich world since the early 1980s, when deregulation of banks, mortgage brokers, and markets for derivatives began to be introduced in the United States (US). Financial companies in rich countries were now allowed to support loans under far less stringent conditions than previously.

There were errors also in macroeconomic management. Fine-tuning is inevitably difficult, but it can be argued that the US Federal Reserve kept interest rates too low for too long. When the institution began to increase the rates banks charge one another for overnight loans, it did so only slowly.<sup>1</sup> Continued fiscal and trade deficit in the US and the corresponding accumulation of reserves by China exacerbated global imbalances. Financial deregulation and a failure of governments in the US (and the UK also) to pursue counter-cyclical monetary policy encouraged an unprecedented leveraging of equity capital and a rapid expansion of liquidity in the rich

\* Paper prepared for the XVI Plenary Session of the Pontifical Academy of Social Sciences, 28 April-4 May 2010, on *Crisis in a Global Economy: Re-Planning the Journey*. I am very grateful to Aisha Dasgupta for helpful advice on the empirics I report here.

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<sup>1</sup> Taylor (2010) argues that had the US Federal Reserve started raising interest rates as early as 2002 (as would have been suggested if the famous 'Taylor rule' had been applied), the housing market would not have grown as fast as it did.

world. Borrowing as much as thirty times one's equity capital was not disallowed to fund a real estate bubble.

The liquidity expansion was accompanied by excessive risk-taking by both borrowers and lenders. The cost of risk fell sharply during the boom period preceding 2007, from a high of about 14 percentage points in 2001 to under 8 percentage points in 2006. As the real estate market was a transparent symptom (even forerunner) of the malaise, the 'financial bubble' was for some time referred to as a 'real-estate bubble'.<sup>2</sup>

The bubble was also accompanied by a lowered cost of capital, which for poor countries fell by 400 base points in the period 2000-2007. The financial market became what can only be called an institutionalized Ponzi-scheme, no different from the much publicised private version Bernard Madoff engineered over those years. Borrowers in rich countries eventually paid the price, but they cannot be absolved from the charge of borrowing beyond their real means.

### 1.1. *From Financial to Economic Crisis*

The financial crisis of 2007-2008 was followed shortly by sharp reductions in real economic activity. That was both predictable and widely predicted by economists. Under prevailing economic institutions in most of the world, a country's gross domestic product (GDP) is strongly correlated with employment. GDP is therefore a good index of economic activity in the short term. The most succinct summary statistic of the economic recession is the rate of growth of GDP, which in rich countries declined from 2.6% in 2007 to -3.3% in 2009.

Predictably, recession in the rich world has had serious implications for people in poor countries. World Bank (2010) has provided an account of

<sup>2</sup> Stiglitz (2010) contains an impassioned account of the economic and political philosophy underlying the deregulation process in the United States. But supporters of the process have begun to counter. Alan Greenspan, who ran the US Federal Reserve for 20 years until 2006, has been reported as insisting (*The Guardian*, 10 April 2010) that the financial bubble was demand driven. In his view rampant demand for property investment encouraged Europeans to buy mortgage-backed securities that were tagged by dubious credit-rating agencies as low risk.

In recent decades financial bubbles and stock market crashes have been much studied by economists. See, for example, Dewatripont and Tirole (1994), Tirole (2002), and Durlauf (2005).

the problems poor countries have faced and are now facing. The authors of the report have shown that the problems themselves and the ability of those countries to respond to them have varied across the poor world. The annual growth rate of GDP in sub-Saharan Africa, for example, fell from a high of 6.5% during 2004-2008 to 1.1% in 2009, whereas the corresponding rates in South Asia (where India dominates the picture) were 8.5% and 5.7%, respectively; and in East Asia (where, with Japan excluded from the statistics, China dominates) the rates were 11.4% and 6.8%.

Admittedly, 5.7% and 6.8% are rates of growth rich countries can only dream of, but Southern and Eastern Asia are operating at a far lower economic base than rich countries. China and India have withstood the global recession well because they are huge, diversified economies. Both countries have been fiscally and financially prudent, with substantial foreign reserves. Domestic demand under good macroeconomic management in large, diversified economies is less vulnerable to external traumas than it is in the myriad of small countries in sub-Saharan Africa. A string of bad monsoons, for example, can cause greater havoc in India than financial meltdowns in London and New York. World Bank (2010) report evidence (such as there is in macro-economic data) that countries with the greatest imbalances (e.g., the public debt to GDP ratio; the public deficit to GDP ratio) have suffered the biggest declines in GDP.

## 1.2. *Contagion from the Rich to the Poor*

Regardless of the quality of their macro-economic management, poor countries have suffered from the recession that was created in the rich world. The recession has seen the deepest percentage reduction in global output since the Great Depression of the 1930s. Global GDP fell by 2.2% from 2008 to 2009. Although a slow recovery appears to be on the way in rich countries (GDP growth is expected to rise to 2.3% in 2011), economic activity is projected to remain below their productive potential for at least a decade.

Perhaps because the world's poorest countries remain economic backwaters, the banking systems there had limited exposure to sub-prime loans. Nevertheless economic activity in the poorest countries has been affected badly and sharply. Industrial production in poor countries fell by 13% between 2008 and 2009. The number of people living under \$1.25 a day (the World Bank's criterion for acute poverty) is now some 65 million more as compared to what the number would have been if the crisis had not hap-

pened. It is estimated too that between 30,000 and 50,000 additional children in sub-Saharan Africa have died of malnutrition in 2009. The annual growth rate of GDP in sub-Saharan Africa during 2004-2008, as noted above, was 6.5% a year, but declined to 1.1% in 2009. As population there grew at about 2.9% last year, per capita GDP *fell* by 1.8%. Income per head in sub-Saharan Africa is some 30 times lower than the average person's income in rich countries. The poor, as always, have had to carry a disproportionate burden of the folly of the rich.

The rate of growth of potential output in poor countries over the next 5 to 7 years will be reduced by 0.2 to 0.7 percent annually. Compared to the pre-crisis era there will be a permanent reduction by 3.4 to 8.0 percent in potential output. As was expected, the recession has cut sharply into government revenues in poor countries, just as it has increased the need for essential government services (e.g. support programmes for the poorest in their countries). The total financing gap in 2010 in poor countries is likely to be \$315 billion.

## 2. TWO QUESTIONS

Having given you a quantitative feel for the effects of the current recession on poor countries, I want to change direction by discussing two sets of questions:

(i) Why do recessions in the rich world transmit their contagion to the poor world?

(ii) When unregulated, why are financial systems particularly vulnerable to excessive risk-taking?

A catalogue of reasons for (i) is provided in Section 4. Question (ii) is addressed in Section 6. There I show that financial deregulation of the kind and extent that has been engineered in the rich world over the past three decades has eroded *trust* among buyers and sellers of risk. I argue also there that the erosion of trust has occurred because deregulation has encouraged *dishonesty* among those who manage the risks faced by others. Deregulation is especially problematic in the financial sector because those with funds (but with little knowledge of financial markets) have no idea of the risks inherent in the portfolios selected by fund managers (i.e., financial traders).

Because deregulation of financial markets of the kind that was carried out in the 1980s is best read as a cause of a breakdown of trust among buyers and sellers of risk, it proves useful to have a catalogue of the circum-

stances under which a group of people can trust one another to do what they said they would do under the terms of an agreement they have reached. That is why the analysis of the particular problems besetting financial markets is presented in reverse order from the general (Section 5) to the particular (Section 6). The Appendix provides the details of the arguments sketched in Section 5.

### 3. FUND MANAGERS AND MEDICAL PRACTITIONERS

In a ground breaking article, Arrow (1963) observed that societies long ago found ingenious ways to minimize the problems of *moral hazard* (doctors choosing treatments that are not in their patients' best interest) and *adverse selection* (quacks practising medicine) that potentially plague the health sector and can destroy the ability of people to find adequate health care.<sup>3</sup> Arrow went on to provide an analysis of the way institutions have evolved to nurture a special relationship between patients and their doctors. That special relationship (at least in its ideal form) is a far cry from the one between anonymous buyers and sellers in the market-place. Imagine what would happen to health care if the health sector was to be deregulated in quite the same way as financial markets. It would involve deregulation in the market for pharmaceuticals, a weakening of the role of national Medical Associations in overseeing the conduct of doctors at their practices, a loosening of the qualifications required for practicing medicine, and so on. Borrowing from Arrow (1963, 2009), I argue below that the character of the relationship between owners of funds (who could be bankers, not just households) and managers of funds should resemble that between patients and their doctors at its ideal. Unfortunately they are far from that. Moreover, deregulation has made the two pairs of relationships even more different. In Section 6 I show why.

<sup>3</sup> The inability to pay is, to be sure, a prime cause of people not receiving adequate medical care in countries where health care is an entirely private commodity. The parallel that I want to draw between financial services and medical services depends on other matters, namely, the problems of asymmetric information between 'buyers' and 'sellers'.

#### 4. CONTAGION

Speculative bubbles have been much studied in the financial literature. That economic recessions are contagious among rich countries has also been much explored, both theoretically and empirically. However, that those same recessions can be contagious for poor countries as well has been studied less, perhaps because they are relatively obvious. Empirical analysis of the effects of the current recession on poor countries is however difficult because the increased difficulties poor countries now face follow a period of boom, when the widened development possibilities open to them were unsustainable. But as rapid deterioration in the prospects for development pose special hardship for poor countries, it makes sense to compare their needs between the unsustainable boom years and the present.

There are seven reasons poor countries suffer when rich countries undergo a recession:

1. Poor countries experience heightened difficulties in the external market for credit and insurance. It has been estimated, for example, that the borrowing costs over the medium run could rise by 110 and 200 base points compared to their levels during the boom period of 2000-2007. Syndicated loans to poor countries in 2009 amounted to \$123 billion, compared to \$236 billion in 2008.

2. Export revenues fall because of a decline in (a) the demand for their goods (world trade in dollars declined by 30% between Summer 2008 and Spring 2009) and (b) the export prices of primary goods (commodity prices, excluding energy, *declined* by 22% in 2009 in contrast to the previous year's experience, which was an *increase* of 21%).

3. The value of foreign holdings decline because of lowered equity returns. The Dow Jones Average declined by 28% during the first half of 2008.

4. Reductions in foreign investment. The flow of foreign direct investment to poor countries fell from \$123 billion in the first quarter of 2007 to \$69 billion in the third quarter of 2009.

5. Reduced aid. It is too soon to judge how deep the cuts will be in foreign assistance to poor countries. But the magnitude of the additional needs of poor countries is huge. It is estimated that 'IDA countries' (countries eligible for soft loans and grants from the International Development Association of the World Bank) will require an additional \$35-50 billion in funding just to maintain current levels of programming, let alone meet the finances required for those additional people thrown into poverty. The total external financing needs of poor countries are expected to be about \$1.1 trillion in 2010.

6. Reduced foreign remittances. Workers' remittances to poor countries declined by 6.3% in 2009, in contrast to an increase by 23% in 2007.

7. Reduced tourism. In recent years tourism receipts in North Africa, for example, amounted to some 15% of GDP. Tourism receipts increased by 20% in 2006 but declined by 5% in 2009.

Reasons (4)-(6) together mean a reduction in capital inflows. Net private capital inflows to developing countries have fallen by nearly \$800 billion in 2009, relative to the high in 2007 (a reduction of 70%).

Recessions are contagious.

## 5. THE PROBLEM OF TRUST

The common problem facing people who wish to transact with others, whether or not the trade is in the buying and selling of risks, is to trust those others to do what they have agreed to do. So, trust among one another comes allied to honest behaviour by all. In the Appendix I go outside my remit here by framing the problem of mutual 'trust' in a general context. Here I summarize the account there so as to apply it to the performance of financial markets. In order to preserve a semblance of continuity in the exposition here, the summary is necessarily brief. If it is found to be too brief, readers should read the Appendix before Section 6.

Imagine that a group of people have discovered a mutually advantageous course of actions. Imagine next that the parties have agreed to share the benefits and burdens of following that course of actions in a certain way. Under what circumstances would the parties trust one another to keep their word?

There are five, possibly overlapping, sets of circumstances in which they are able to do so. Those circumstances are:

- (1) The people involved care about one another.
- (2) The people involved are known to be honest even when the cost they bear in being honest is large.
- (3) There is a trustworthy external enforcer of agreement. When the external enforcer is the State, trust is created and sustained by a reliance on the *rule of law*, whose practice involves the imposition of penalties on those who break agreements without cause. (Of course, ensuring that the external enforcer is trustworthy involves the creation of appropriate incentives, which are the subject of (4) and (5) below).
- (4) The parties care about their reputation. They could care either because people unconditionally care that others recognise they are honest

((2) on our list) or because sanctions will be imposed on them if they are found to be dishonest ((5) on our list).

(5) The parties mutually enforce the agreement by a reliance on *social norms* of behaviour. Social norms involve the (credible) imposition of social sanctions. Entering into long term relationships is an aid to the practice of norm-based behaviour.

Suppose we now think of the respective parties as fund-managers and those with funds seeking others to manage their funds in the owners' interest. Then clearly (1) is not applicable. Moreover, even though in an ideal world our upbringing would be so tailored that honesty is a natural behavioural trait, there is no reason to think that fund managers are especially disposed to be honest when opportunistic behaviour reaps financial rewards. I conclude society should not rely on (2) to elicit honesty in financial markets.

As (1) and (2) do not apply, *incentives* are required to elicit trustworthy behaviour. In Section 6 it is argued that such incentives have been dulled by deregulation. Deregulation has meant a weakening of (3), because regulators do not even have to judge whether financial traders and fund managers are acting in the best interests of their clients. That leaves us with (4) and (5). I show that, unfortunately, deregulation has also weakened the scope of both (4) and (5).

## 6. MARKETS FOR RISK

Financial markets involve trade in risks. There is a general reason markets encourage risktaking even among people who are otherwise risk averse and even when the risks are commonly known. Limited liability (a good thing) means that the worst that can happen to a firm if things go dreadfully wrong through no fault of its own is that it goes bankrupt. That sets a floor to losses. So, a 50% chance of bankruptcy (amounting, say, to a loss of 5 million dollars), when allied to a 50% chance of success (amounting, say, to a gain of 55 million dollars) can look better than a sure bet yielding 25 million dollars even to someone who is otherwise risk averse. Limited liability leads to risky behaviour.

There are further, related problems. When I purchase a security, I am promised a payment on condition that a set of specified events occurs. Payments on government and corporate bonds and bank loans are no doubt specified in time and quantity, but there is always a risk of default (no matter how slight in the case of government bonds) contingent on certain

events. The interesting and important point here is that the events on which default is contingent depend at least in part on economic variables (e.g., an economic 'crisis'). In short, the returns on securities are dependent on happenings that are not exogenous to the economic system (e.g., weather), but are endogenous to it (e.g., expectations people hold about future prices of good and services). Moreover, the risks are not measurable. As each transaction involves in effect a one-shot risk, there are no objective probabilities for guiding decisions. The buyer of a security and the trader in securities will typically have different assessments of the risks, but as the assessments are lodged in the mind, there is no way for the buyer to verify whether the trader is acting in the buyer's interests.

That is why traders' fees are based on performance (the bonus culture), a natural thing on which to base fees, since performance (*viz.* returns) can be observed by both parties.<sup>4</sup> But as a security's risks are played out over time, performance payments should be spread out over years. Currently though, they are not. Traders are rewarded for short run success, but are not punished for long run failure. They therefore have an incentive to choose strategies that have a high probability of short run success even if that means a high probability of long term failure. Even in the medium run they are not to be seen: traders in derivatives appear to retire early with their earnings. This prevents the development of long-term relationships between those who desire to invest their funds and those who manage the funds. The fund manager's word is no longer a bond. This contributes to bankruptcies and market volatility.

In Section 5 we noted that of the five circumstances in which buyers and sellers can trust one another to behave in accordance with their agreement, the first two do not apply. Deregulation has vastly weakened the power of the third (external enforcement of agreements).<sup>5</sup> In the Appendix I show why, if either the fourth or fifth set of circumstances is to prevail in the financial market, society should put in place accountability over a long period of time, not just a year or thereabout. As in other kinds of transaction, external enforcement, the force of social norms of behaviour, and the cultivation of honesty are all needed if financial markets are to operate well.

<sup>4</sup> Payment based on performance was a familiar matter in plantations, where workers were paid a piece rate, not time rate. That way there would be no need to enforce hard work: workers would have the incentives to work hard. Piece rates in agriculture are rare now because machines set the pace of work.

<sup>5</sup> Stiglitz (2010) has a good discussion of the regulatory measures that are now needed.

APPENDIX<sup>6</sup>

## A1. TRUST AND COOPERATION

Imagine that a group of people have discovered a mutually advantageous course of actions. At the grandest level, it could be that citizens see the benefits of adopting a Constitution for their country. At a more local level, the undertaking could be to share the costs and benefits of maintaining a communal resource (irrigation system, grazing field, coastal fishery); construct a jointly useable asset (drainage channel in a watershed); collaborate in political activity (civic engagement, lobbying); do business when the purchase and delivery of goods can't be synchronized (credit, insurance, wage labour); enter marriage; create a rotating saving and credit association (as in the institution of *iddir* in Ethiopia); initiate a reciprocal arrangement (I help you, now that you are in need, with the understanding that you will help me when I am in need); adopt a convention (send one another Christmas cards); create a partnership to produce goods for the market; conduct an instantaneous transaction (purchase something across the counter); hand over funds to a fund manager; and so on. Then there are mutually advantageous courses of action that involve being civil to one another. They range from such forms of civic behaviour as not disfiguring public spaces and obeying the law more generally, to respecting the rights of others.

Imagine next that the parties have agreed to share the benefits and costs in a specified way. At the grandest level the agreement could be a social contract among citizens to observe their Constitution. Or it could be a tacit agreement to be civil to one another, such as respecting the rights of others to be heard, to get on with their lives, and so forth. Here we will be thinking of agreements over transactions in goods and services. There would be situations where the agreement was based on a take-it-or-leave-it offer one party makes another (as when a purchaser accepts the terms and conditions in a supermarket). In other contexts, bargaining may have been involved (as in a Middle-Eastern bazaar). I do not ask how agreements have been reached, nor look for principles of equity that might have been invoked during negotiation (but see below). I ask instead: *Under what circumstances would the parties who have reached agreement trust one another to keep their word?*

<sup>6</sup> This Appendix is based on Dasgupta (2009).

Because one's word must be credible if it is to be believed, mere promises wouldn't be enough. (Witness that we caution others, and ourselves too, not to trust people 'blindly'). If the parties are to trust one another to keep their promise, matters must be so arranged that: (1) at every stage of the agreed course of actions, it would be in the interest of each party to plan to keep his or her word if all others were to plan to keep their word; and (2) at every stage of the agreed course of actions, each party would believe that all others would keep their word. If the two conditions are met, a system of beliefs that the agreement will be kept would be self-confirming.

Notice that condition (2) on its own wouldn't do. Beliefs need to be justified. Condition (1) provides the justification. It offers the basis on which everyone could in principle believe that the agreement will be kept. A course of actions, one per party, satisfying condition (1) is called a *Nash equilibrium*, in honour of the mathematician John Nash (he of *the beautiful mind*) who proved that it is not a vacuous concept (Nash, 1950). By their very definition, Nash equilibria (there can be more than one equilibrium; see below) are *self-enforcing*, which is why the parties in question would seek to identify them.

Notice that condition (1) on its own wouldn't do either. It could be that it is in each agent's interest to behave opportunistically if everyone believed that everyone else would behave opportunistically. In that case non-cooperation is also a Nash equilibrium, meaning that a set of mutual beliefs that the agreement will not be kept would also be self-confirming and, thereby, self-enforcing. Stated formally, a Nash equilibrium is a set of strategies, one per agent, such that no agent would have any reason to deviate from his or her course of actions if all other agents were to pursue their courses of actions. Generally speaking, societies harbour more than one Nash equilibrium. Some yield desirable outcomes, others do not. The famous Prisoners' Dilemma is a game that has a unique Nash equilibrium in which all parties are worse off than they could have been if a suitable cooperative infrastructure had been in place. The fundamental problem facing a society is to create institutions where conditions (1) and (2) apply to engagements that protect and promote its members' interests.

Conditions (1) and (2), taken together, require an awful lot of coordination among the parties. In order to probe the question of which Nash equilibrium can be expected to be reached, if a Nash equilibrium is expected to be reached at all, economists study human behaviour that are *not* Nash equilibria. The idea is to model the way people form beliefs about the way the world works, the way people behave, and the way they revise their

beliefs on the basis of what they observe. The idea is to track the consequences of those patterns of belief formation so as to check whether the model economy moves toward a Nash equilibrium over time, or whether it moves about in some fashion or other but not toward an equilibrium.

This research enterprise has yielded a general conclusion: Suppose the economic environment in a certain place harbours more than one Nash equilibrium. Which equilibrium should be expected to be approached, if the economy approaches an equilibrium at all, will depend on the beliefs that people held at some point in the past. It also depends on the way people have revised their beliefs on the basis of observations since that past date. This is another way of saying that history matters. Model building, statistical tests on data relating to the models, and historical narratives have to work together synergistically if we are to make progress in understanding our social world. Unfortunately, the study of disequilibrium behaviour would lengthen this Appendix greatly. I show below though that, fortunately, a study of equilibrium behaviour takes us a long way.

## A2. CREDIBLE PROMISES

We began by observing that mutual trust is the basis of cooperation. In view of the multiplicity of Nash equilibria and the possible awfulness of equilibria in those social environments where a cooperative infrastructure is absent, we look for environments in which cooperation is possible. To do that it proves useful to classify the social environments in which the promises people make to one another are *credible*. Five come to mind (Dasgupta, 2007).

### A2.1. *Mutual Affection*

Promises would be credible if the parties cared about one another sufficiently. Innumerable transactions take place only because the people involved care about one another and rationally believe that they care about one another (each knows that the others know that they care about one another, each knows that the others know that each knows that they care about one another, and so on) and thus trust one another to carry out their obligations. The household best exemplifies institutions based on care and affection. Because people who cohabit are able to observe and know one another, they can be sanguine that members will not be unduly opportunistic. The problem is that, being few in number, members of a household, as

a group, are unable to engage in those enterprises that require large numbers of people of varied talents and locations. That is why mutual affection is not the basis of cooperation in most other contexts.

### *A2.2. Pro-social Disposition*

Promises would be credible if it were common knowledge that those making the promises were trustworthy, or that they reciprocated by keeping their promise if others displayed trust in them. The new behavioural economics emphasises this aspect of human character (see, e.g., Rabin, 1993; Fehr and Fischbacher, 2002). Nature and nurture play a still little-understood combined role in developing in us a general disposition to reciprocate (Hinde and Groebel, 1991; Ehrlich, 2000). Our capacity to have such feelings as shame, affection, anger, elation, obligation, benevolence, and jealousy would appear to have emerged under selection pressure. No doubt culture helps to shape preferences, expectations, and thus, behaviour, which are known to differ widely across societies. But cultural coordinates enable us to identify the locus of points *upon* which shame, affection, anger, elation, obligation, benevolence, and jealousy are put to work; they don't displace the centrality of those capacities in the human make-up. The thought I am pursuing here is that as adults we not only have a disposition for such behaviour as paying our dues, helping others at some cost to ourselves, and returning a favour; we also practise such norms as those which prescribe that we punish those who have hurt us intentionally; and even such higher-order-norms as shunning those who break agreements, on occasion frowning on those who socialise with people who have broken agreements; and so forth. Often enough, the disposition to be honest would be toward members of some particular group (clan, or neighbours, or ethnic group), not others. This amounts to group loyalty (Ehrlich, 2000, has an excellent discussion on these matters).

By internalizing specific norms, a person enables the springs of his actions to include them. He therefore feels shame or guilt in violating the norm, and this prevents him from doing so, or at the very least it puts a break on him, unless other considerations are found by him to be overriding. In short, his upbringing ensures that he has a disposition to obey the norm, be it moral or social. When he does violate it, neither guilt nor shame would typically be absent, but frequently the act will have been rationalized by him. For such a person, making a promise is a commitment, and it is essential for him that others recognise it to be so (Arrow, 1974).

Recent work in behavioural economics has re-affirmed among economists that trustworthiness isn't alien to human nature. The problem is that, as people don't have their inherent trustworthiness stamped on their forehead, they can't know in advance whom to trust. In any event, if relative to the gravity of the misdemeanour the pecuniary benefits of opportunistic behaviour were high, transgression could be expected. The problem is that one wouldn't know in advance who would be likely to transgress. Punishment assumes its role as a deterrence because of these agency problems. As someone's trustworthiness isn't publicly observable, punishment is usually tailored to the 'crime'. In the next section we study the remaining three contexts in which people are able to trust one another to keep their promises. We will confirm that, by looking into someone's personal history it becomes possible to tailor punishment not only to the 'crime', but also their past behaviour and circumstances.

### A3. INCENTIVES TO KEEP PROMISES

The promises the parties have made to one another to keep to their agreement would be credible if they could devise an institution in which keeping promises would be in the interest of each party if everyone else were to keep them. The problem therefore is to devise an institution in which keeping to the agreement is a Nash equilibrium. Recall that a strategy is a sequence of conditional actions. Strategies assume the forms, 'I shall choose X if you choose Y, otherwise I shall choose Z', or 'I shall do P if Q occurs, otherwise I shall do R', and so on. If promises are to be credible, it must be in the interest of those making promises to carry them out if and when the relevant occasions arise.

Societies everywhere have constructed solutions to the credibility problem, but in different ways. *What all solutions have in common is the imposition of collective sanctions on those who intentionally do not comply with agreements.* Of course, a credible threat of punishment for misdemeanours would be an effective deterrence only if future costs and benefits aren't discounted at too high a rate relative to other parameters of the social environment, a matter to which I return presently.

Broadly speaking, there are three types of situation where parties to an agreement could expect everyone to keep to their words. (Of course, none may be potent in a particular context, in which case people would find themselves in a hole they cannot easily get out of, and what could have been

mutually beneficial agreements will not take place. The behaviour reported in the Mezzogiorno by Banfield, 1958, is an illustration of this possibility). Each gives rise to a set of institutions that capitalize on its particular features. In practice, of course, the types would be expected to shade into one another; but it pays to study them separately. So, in the next three subsections I assume that the discount rates agents apply to their future costs and benefits are low relative to other parameters of the social environment.

### A3.1. *External Enforcement*

It could be that the agreement is translated into an explicit contract and enforced by an established structure of power and authority; that is, an external enforcer.

By an external enforcer I imagine here, for simplicity, the State. (Depending on the social environment, the 'external enforcer' could be the tribal chieftain, the warlord, the priest, or the village elders). Consider that the rules governing transactions in the formal market-place are embodied in the law. So markets are supported by a legal structure. Firms, for example, are legal entities. Even when you go to a supermarket, your purchases (paid in cash or by card) involve the law, which provides protection for both parties (the grocer, in case the cash is counterfeit or the card is void; the purchaser, in case the product turns out on inspection to be sub-standard). The law is enforced by the coercive power of the State. Transactions involve legal contracts backed by an external enforcer, namely, the State. It is because you and the supermarket owner are confident that the State has the ability and willingness to enforce contracts that you and the owner of the supermarket are willing to transact.

What is the basis of that confidence? After all, the State apparatus is run by people, which means a further agency problem. In any event, the contemporary world has shown that there are States and there are States. Simply to invoke an external enforcer for solving the credibility problem won't do. For why should the parties trust the State to carry out its tasks in an honest and effective manner? A possible answer is that the government worries about its reputation (Section A3.2). So, for example, a free and inquisitive press in a democracy helps to sober the government into believing that incompetence or malfeasance would mean an end to its rule, come the next election. Knowing that they worry, so the parties trust their government to enforce agreements. Even if senior members of the ruling party are getting on in years and don't much care what happens in the future,

younger members would worry that the party's reputation would suffer if the government were not to behave.

The above argument involves a system of interlocking beliefs about one another's abilities and intentions. Consider that millions of households in many parts of the world trust their government (more or less!) to enforce contracts, because they know that government leaders know that not to enforce contracts efficiently would mean being thrown out of office. In their turn, each side of a contract trusts the other not to renege (again, more or less!), because each knows that the other knows that the government can be trusted to enforce contracts. And so on. Trust is maintained by the threat of punishment (a fine, a jail term, dismissal, or whatever) for anyone who breaks a contract. We are in the realm of equilibrium beliefs, held together by their own bootstraps.

Unfortunately, cooperation isn't the only possible outcome. Non-cooperation can also be held together by its own bootstrap. At a non-cooperative equilibrium the parties don't trust one another to keep their promises, because the external enforcer cannot be trusted to enforce agreements. To ask whether cooperation or non-cooperation would prevail is to ask which system of beliefs are adopted by the parties about one another's intentions. Social systems harbour multiple equilibria.

### *A3.2. Reputation as Capital Asset*

Political parties are not the only entities that view reputation as a capital asset. Individuals and firms view it that way too. Consider someone who doesn't care what his reputation will be after death. Even he would care to build a reputation for honest dealing if by so doing he could cash in that reputation at the time of retirement. Brand names are an instance of such cases. The person owning the brand name no doubt changes over time, but the name itself remains. Consider a firm whose dishonest behaviour has been exposed. Suppose too that customers deal only with firms that have an unsullied reputation. On retirement, the owner would find no buyer for the firm. Knowing that in advance, the owner may well wish to maintain the firm's reputation for honesty. If the owner cared sufficiently about his quality of life after retirement, honesty would then be an equilibrium strategy, just as boycotting ill-reputed firms would be a corresponding equilibrium strategy for customers (Kreps, 1990).

Of course, even in situations where reputation can be accumulated as a capital asset, it may be that agents don't accumulate reputations for hon-

esty. It cannot be repeated often enough that social systems possess multiple equilibria.

The formal analysis of reputation as capital asset is similar to one where the parties expect to face transaction opportunities repeatedly in the future. Let us study those situations.

### A3.3. *Long-term Relationships*

Suppose the agents expect to face similar transaction opportunities in each period over an indefinite future. Imagine too that the parties can't depend on the law of contracts because the nearest courts are far from their residence. There may even be no lawyers in sight. In rural parts of sub-Saharan Africa, for example, much economic life is shaped outside a formal legal system. But even though no external enforcer may be available, people there do transact. Credit involves saying, 'I lend to you now with your promise that you will repay me'; and so on. But why should the parties be sanguine that the agreements won't turn sour on account of opportunistic behaviour?

They would be sanguine if agreements were mutually enforced. The basic idea is this: a credible threat by members of a community that stiff sanctions would be imposed on anyone who broke an agreement could deter everyone from breaking it. The problem then is to make the threat credible. The solution to the credibility problem in this case is achieved by recourse to social norms of behaviour.

By a *social norm* we mean a rule of behaviour, or strategy, that is followed by members of a community. For a rule of behaviour to *be* a social norm, it must be in the interest of everyone to act in accordance with the rule if all others were to act in accordance with it. Social norms are (Nash) equilibrium rules of behaviour.

To see how social norms work, imagine that the gain to a party from breaking the agreement unilaterally during a period is less than the discounted value of the losses she would suffer if all other parties were to punish her subsequently. The punishment could involve all others refusing to engage in any transactions with the erring party in the following period, shunning her for suitable numbers of periods, and so on. Call a party 'conformist' if she cooperates with parties who are conformists but punishes those who are non-conformists. That sounds circular, but it isn't, because the social norm we are studying here requires all parties to start the process by keeping their agreement. It would then be possible for any party in any period to determine

which party is conformist and which party is not. For example, if ever someone were to break the original agreement, he would be judged to be non-conformist; so, the norm would require all parties to punish the non-conformist. Moreover, the norm would require that punishment be inflicted not only upon those in violation of the original agreement (first-order violation); but also upon those who fail to punish those in violation of the agreement (second-order violation); upon those who fail to punish those who fail to punish those in violation of the agreement (third-order violation); and so on, indefinitely. This infinite chain makes the threat of punishment for errant behaviour credible because, if all others were to conform to the norm, it would not be worth any party's while to violate the norm. Keeping one's agreement would then be self-enforcing (Fudenberg and Maskin, 1986).

All traditional societies appear to have sanctions in place for first-order violations. Anthropologists and novelists have noted the use of sanctions for second-order violations. That sanctions against higher-order violations haven't been documented much may be because they aren't needed to be built into social norms if it is commonly recognised that people feel a strong emotional urge to punish those who have broken agreements. Anger facilitates cooperation by making the threat of retaliation credible.

Social norms that are enshrined in the culture of a community depends not only on the character of the agreements themselves, but also on the relative ease with which prospects are expected to arise for opportunistic behaviour. Sanctions can range from the punitive and unforgiving ('one strike and you are out!', known in the literature as the 'grim strategy'), which have been observed in places where tempting short-term outside economic opportunities appear from time to time. However, many rural communities (e.g. in the mountains of Nepal) are like enclaves: they live far from established markets. Adopting such unforgiving norms as 'one strike and you are out!' would prove counter-productive there. That is why sanctions there have been found to be graduated: the first misdemeanour is met by a small punishment, subsequent ones by stiffer punishments, persistent ones by punishments that are stiffer still (Ostrom, 1992). Where information is imperfect, a small penalty for the first misdemeanour would be warning that others were watching, or it could be that others signal their acknowledgement that the misdemeanour could have been an error on the part of the offender and that he should try harder next time. And so on.

It can be shown that the scope for cooperation can be increased by *tying* several agreements (e.g., agreements over the mutual provision of credit, insurance, and labour, respectively), so that the norm has it that violation

of any one agreement is met by withdrawal of cooperation in all other engagements (Dasgupta, 2007). Interestingly, tied relationships are a common feature of traditional societies.

Unfortunately, even when cooperation is a possible equilibrium, non-cooperation is an equilibrium too. To see why, imagine that each party believes that all others will renege on the agreement. It would then be in each one's interest to renege at once, meaning that there would be no cooperation. Failure to cooperate could be due simply to an unfortunate pair of selfconfirming beliefs, nothing else. No doubt it is mutual suspicion that ruins their chance to cooperate, but the suspicions are internally self-consistent. In short, even when people don't discount future costs and benefits at a high rate and appropriate institutions are in place to enable people to cooperate, it can be that they do not cooperate. Whether they cooperate depends on mutual beliefs, nothing more. I have known this result for many years, but still find it a surprising and disturbing fact about social life.

#### A4. BREAKDOWN OF COOPERATION

We have so far assumed that the discount rates people apply to their future gains and losses are small. It is, of course, obvious that if the rates were large, cooperation wouldn't be possible. So we now have in hand a tool to explain how a community where members have been cooperating can skid to a state of affairs where members cease to cooperate. Ecological stress (caused, for example, by high population growth and prolonged droughts) often leads people to fight over land and natural resources (Homer-Dixon, 1999; Diamond, 2005). More generally, political instability (in the extreme, civil war) would be a reason why people discount the future benefits of cooperation at a high rate, if for no other reason than a heightened fear that their community will not survive in its present shape. In the sphere of financial markets, that traders are able to reap high benefits in a brief span of time (the bonus culture based on short run performance) and then disappear translates into high discount rates. Which is when the bubble bursts. For whatever reason, if discount rates were to increase sufficiently relative to the parameters characterising the social environment, cooperation would cease. Mathematicians call the points at which those switches occur, 'bifurcations', sociologists call them 'tipping points'. Social norms work only when people have reasons to value the future benefits of cooperation.

Contemporary examples illustrate this. Local institutions have been observed to deteriorate in the unsettled regions of sub-Saharan Africa. Communal management systems that once protected Sahelian forests from unsustainable use were destroyed by governments keen to establish their authority over rural people. But Sahelian officials had no expertise at forestry, nor did they have the resources to observe who took what from the forests. Many were corrupt. Rural communities were unable to switch from communal governance to governance based on the law: the former was destroyed and the latter didn't really get going. The collective vacuum has had a terrible impact on people whose lives had been built round their forests and woodlands (Dasgupta, 1993).

Ominously, there are subtler pathways by which societies can tip from a state of mutual trust to one of mutual distrust. We have seen that when discount rates are low, both cooperation and non-cooperation are equilibrium outcomes. So, a society could tip over from cooperation to non-cooperation simply because of a change in beliefs. The tipping may have nothing to do with any discernable change in circumstances; the entire shift in behaviour could be triggered in people's minds. The switch could occur quickly and unexpectedly, which is why it would be impossible to predict and why it would cause surprise and dismay. People who woke up in the morning as friends would discover at noon that they are at war with one another. Of course, in practice there are usually cues to be found. False rumours and propaganda create pathways by which people's beliefs can so alter that they tip a society where people trust one another to one where they don't.

The reverse can happen too, but it takes a lot longer. Rebuilding a community that was previously racked by civil strife involves building trust. Non-cooperation doesn't require as much coordination as cooperation does. Not to cooperate usually means to withdraw. To cooperate, people must not only trust one another to do so, they must also coordinate on a social norm that everyone understands. That is why it's a lot easier to destroy a society than to build it.

How does an increase or decrease in cooperation translate into macro-economic performance? Consider two communities that are identical in all respects, excepting that in one people have coordinated at an equilibrium where they trust one another, while people in the other have coordinated at an equilibrium where they don't trust one another. The difference between the two economies would be reflected in the productivity of their assets, which would be higher in the community where people trust one another

than in the one where they don't. Enjoying greater incomes, individuals in the former economy are able to put aside more of their income to accumulate capital assets, other things being equal. So it would become relatively more wealthy. Mutual trust would be interpreted from the statistics as a driver of economic growth, but the statistics wouldn't reveal how that trust was created and maintained.

#### A5. DECENCY AND THE RULE OF LAW

Many thinkers point to the primacy of the rule of law for societal well-being. The rule of law, however, is consistent with many forms of government and international political arrangements. It isn't only a political democracy in the Western mode that can be expected to protect and promote the rule of law. Practice of the rule of law, more generally, an expectation of *decency* in the public domain, creates trust among people, as they go about their daily lives. That is why we economists should now work more closely with educationists and other social scientists so as to better understand the social environments that promote the growth of pro-social disposition. To be true to oneself is in all probability the surest route to being true to others. The mystery is how to enlarge the set of those 'others' beyond one's neighbours. The deepest question in the social sciences remains unanswered: how does grace and decency establish themselves among wide and disparate groups of people?

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# REGULATIONS, REGULATORS, CONTROLLERS AND GOVERNMENTS

ANGELIKA NUßBERGER

## REGULATION AND DEREGULATION

‘I tell you not to worry about your life. Don’t worry about having something to eat, drink, or wear. Isn’t life more than food or clothing? Look at the birds in the sky! They don’t plant or harvest. They don’t even store grain in barns. Yet your Father in heaven takes care of them. Aren’t you worth more than birds?’<sup>1</sup> – This biblical saying mirrors one of the dearest wishes of mankind – to live without ‘fear and want’. Although confidence in the future is an essential, even an indispensable basis for a stabilized and well balanced economic and social development we understand that it is unavoidable to ‘worry about life’ and to plan for the future. Due to the fragility of world economy and social injustice in the globalised world of the 21st century good rules and regulations are probably more important now than ever before. *Laissez faire* would mean an unfettered competition and ruinous developments in world economy. We could have a glimpse of what that might mean in 2008 and 2009. Yet, the quote from the Bible carries a very important message: material well-being is something we need but not all we should aspire to.

International regulations in the field of trade and finance are very complex. It might be worth using a metaphor to describe the basic problems. Imagine an empty square billiard table with green felt. A group of people agrees on playing together; they define the size of the balls and sticks and they decide on the rules of the game. Later on more and more players want to join in. They are admitted, but there are only smaller balls and shorter sticks left.

<sup>1</sup> Matthew 6:25-26.

And somehow the new players realise that the table is uneven; the balls always run to the same end. Those who had started the game know which position to choose; they always win. The newcomers fail to convince the experienced players to re-adjust the table and to start a new game with new rules. They have only two possibilities: either they keep playing or they stop and retreat.

This metaphor might visualize that a certain setup of rules can lead to an unfair game where it is fixed in advance who will be the winner and who will be the loser. Due to such rules the wealth of the Earth is currently being used and redistributed in an unfair manner. Over the last decades despite all the regulations elaborated the differences between living conditions in the richest and the poorest countries have not declined. Some new strong players have joined in and try to ignore the rules.

Yet, deregulation is not a solution. Deregulation such as it is described in Professor Dasgupta's paper kept the game on the same unequal track, did not allow for fair play, but kept the advantages for the insiders and caused additional disadvantages for the outsiders. Therefore it did not bring about a fundamental change, but perpetuated and – as we can see – even deteriorated the problems that had existed already before. Therefore it is common sense that rules are necessary. Yet, the existence of rules per se is not sufficient. It is necessary to have good and efficient rules that are applied in practice and bring about the effects wanted.

#### RULES 'FROM ABOVE' AND RULES 'FROM BELOW'

Rules cannot only be used as a tool 'from above', but also as a tool 'from below'. Regulations 'from above' comprise rules on the economic power play, e.g. trade regulations, customs, intellectual property, pricing, export and import quotas, exchange rates, etc. Such rules determining the economic and financial interaction have to be complemented by rules 'from below'. The latter do not define the rules of the game directly, but make clear in how far economic activities have repercussions on social life and draw red lines.

If we want to stretch the metaphorical approach a bit further we can say that the 'standards from below' define that, whatever the rules of the game, the outcome must be such as to allow every player to win at least one little ball. If there are some who only lose and always lose, they will not be able to survive. That means we have to define some rules as a basic survival kit.

At the national level we have seen that the interplay of regulations 'from above' and 'from below' is useful. We need both economic and financial law

to set the economy going and social law in order to provide a basic safety net. We wish something similar at the international level, but we are still very far away from this goal.

The present paper deals with international social law and analyses the interplay between regulations, regulators, controllers and governments in this field. The basic question is in how far social standards can be a valid tool to prevent or, if prevention is not possible, to respond to distortions in the economic sphere.

#### THESES ON INTERNATIONAL SOCIAL LAW

The effects of international social standards can be summed up in the following ten theses:

- 1) Despite the elaboration of international social standards for over one century social inequalities on the world-wide scale have not been erased and probably not even been reduced. They are as drastic as they have always been.
- 2) International social standards have not played a significant role neither in preventing world economic, financial and social crises, nor in mitigating the consequences.
- 3) Social standards at the national level have had a much greater success story. At least to a certain extent they have helped to smooth out social inequalities and to prevent large-scale misery in the event of economic and financial crisis.
- 4) The transfer of success models from the national level to the international level will rarely have the effects wanted.
- 5) There is always a clash of interests in defining international social standards.
- 6) Regional social standards tend not to be very different from universal ones.
- 7) Social standards are either too abstract or too concrete.
- 8) Law-making at the international level tends to be very bureaucratic, slow and inflexible. The same is true for control mechanisms.
- 9) International social law might have unexpected positive effects.
- 10) Despite all problems and draw-backs it is necessary to continue on the path of determining social standards at the international level.

These ten theses will be elaborated further in the paper. The term 'international social standards' and 'international social law' is understood in the

broadest sense comprising both hard and soft law, both labour law and social security law, both regional and universal international law.

*First, despite the elaboration of international social standards for over one century social inequalities on the world-wide scale have not been erased and probably not even been reduced. They are as drastic as they have always been.*

It is difficult to give an exact date for the beginning of international social legislation.

The first visible step after the theoretical discussion of international social standards for many decades since the end of the 18th Century was the organisation of an International Conference in Berlin in 1890 which brought together the main industrialised countries basically accepting the necessity of international regulations in the social field. Although the Conference was a failure as the participating 13 States could not agree on binding norms, in the doctrine of international law the initiative was understood as something new, even as something challenging the traditional concept of international law. Thus Alphonse Rivier interpreted the new approach as 'utopia that could, up to the present time, exert its disastrous effects only in national legislation'.<sup>2</sup>

The first tangible result was the elaboration of two international conventions that were deemed necessary to counteract major social abuses: the *International Convention on the Prohibition of the Use of White (Yellow) Phosphore*<sup>3</sup> and the *International Convention on the Prohibition of Night Work of Women in Industries*,<sup>4</sup> both dating back to 1908. The first convention aimed to improve the detrimental conditions in the production of matches and thus focused on workers' protection. The second convention shows that night work of women – almost universally accepted nowadays – was seen as a shocking sign of social and moral decline at the beginning of the 20th century. The prohibition was also understood as an instrument of workers' protection. So we might take those two conventions as the starting-point for international legislation protecting a certain group of people against exploitation for economic profit.

As the elaboration and ratification of those conventions did not engender further standard-setting activities, the real starting-point of internation-

<sup>2</sup> Rivier, *Droit des gens*, Tome I, 1896, p. 362.

<sup>3</sup> Mahaim, *Droit international ouvrier*, 1913, p. 366 et seq.

<sup>4</sup> Mahaim, *Droit international ouvrier*, 1913, p. 371 et seq.

al social legislation has to be seen in 1919 when the International Labour Organisation was founded on the basis of the Versailles Treaty. In 1919 international law-making in the field both of labour and social law was *de iure* and *de facto* institutionalised.

Social differences were enormous at that time. Whereas Europe, at least the Western part, was already highly industrialised, but suffered from the consequences of the First World War, most of the territories of the world were still under colonial domination. The discrepancies between the rich and the poor were outraging, both within the States and between the States.

Although the world has changed dramatically since – with very few exceptions there are no more colonies, more than sixty years have passed since the last World War –, we are confronted with the same problems: the poorest can hardly survive whereas in a small part of the world the lack of clean water and hunger are almost unknown.

About 200 conventions in the field of labour and social law,<sup>5</sup> major codifications of social rights as a part of human rights law<sup>6</sup> and countless resolutions and other soft law instruments could not visibly change the face of the world.

*Second, international social standards have not played a significant role neither in preventing world economic and social crises, nor in mitigating their consequences.*

Law-making in the social field was always reactive and not proactive. The idea to elaborate social standards against the misuse of economic power and the distortion of competition was an answer to the negative consequences of industrialisation and economic laissez-faire systems leading to the exploitation of the weakest members of societies. Thus it was the credo of enlightened entrepreneurs and social reformers such as Robert Owen and Daniel Legrand that effective measures against unfair labour conditions have to be taken at the international and not at the national level in order to avoid disadvantages for progressive law-makers.

The foundation of the International Labour Organisation was pushed by the shock of the First World War, which was, at least partially,

<sup>5</sup> Up to 2010 the International Labour Organisation has adopted 188 conventions and 199 recommendations.

<sup>6</sup> The most important is the International Covenant on Economic, Social and Cultural Rights.

explained as an unavoidable consequence of social tensions and disequilibrium between the states.

The same is true for the impetus to define international human rights after the Second World War. It is a lesson learnt from the human sufferance during the World War that both 'freedom from fear' and 'freedom from want' form the basis of human dignity. Thus Article 22 and Article 25 of the Universal Declaration of Human Rights can be considered as a reaction to the deep and all-embracing social crisis brought about by completely misguided politics in the 1930s and 1940s:

Everyone, as a member of society, has the right to social security and is entitled to realization, through national effort and international co-operation and in accordance with the organization and resources of each State, of the economic, social and cultural rights indispensable for his dignity and the free development of his personality (Art. 22).

Everyone has the right to a standard of living adequate for the health and well-being of himself and of his family, including food, clothing, housing and medical care and necessary social services, and the right to security in the event of unemployment, sickness, disability, widowhood, old age or other lack of livelihood in circumstances beyond his control (Art. 25 para. 1).

These norms are not binding per se – if they are not interpreted as part of customary international law –, but the basic ideas were taken up in subsequently elaborated international conventions such as Convention No. 102 'Minimum standards in social security' (1952) and the International Covenant on Economic, Social and Cultural Rights (ICESCR).

The relevant provisions in the International Covenant on Economic, Social and Cultural Rights read:

The States Parties to the present Covenant recognize the right of everyone to social security, including social insurance (Article 9).

The States Parties to the present Covenant recognize the right of everyone to an adequate standard of living for himself and his family, including adequate food, clothing and housing, and to the continuous improvement of living conditions. The States Parties will take appropriate steps to ensure the realization of this right, recognizing to this effect the essential importance of international co-operation based on free consent (Article 11 para. 1).

Such standards coming 'from below', from the social area, are not a tool to prevent international financial crises with disastrous economic and

social consequences as they cannot influence the rules applied in international financing. The question is if they could mitigate the consequences of a crisis. Theoretically this might be the case. As it is true that it is not possible to redistribute more than what has been earned, in the case of a crisis it is necessary to make cuts. Social standards could avoid cuts that hit the most vulnerable groups and push people below the subsistence level. If taken seriously, States could be forced to guarantee the rights of the poorest under all circumstances and to spare them from cuts.

But we have to realize that the social security and poverty alleviating human rights standards we currently have were not meant to be an immediate relief system. They were set up to gradually transform the existing systems and to improve social coherence in national societies.

Thus Article 2 of the International Covenant on Economic, Social and Cultural Rights reads:

Each State Party to the present Covenant undertakes to take steps, individually and through international assistance and co-operation, especially economic and technical, to the maximum of its available resources, with a view to achieving progressively the full realization of the rights recognized in the present Covenant by all appropriate means, including particularly the adoption of legislative measures.

There is no explicit provision in the Covenant on crisis management. Nevertheless, due to economic recession in the 1990s there has been a fierce discussion about the admissibility of the reduction of social benefits. The official comment given by the Committee on Economic, Social and Cultural Rights to this problem shows more open questions than answers. It defines the prohibition of retrogression as a rule and tries to circumscribe the exemptions. The essential idea is that, if retrogressive measures are unavoidable, certain procedural safeguards have to be followed, there has to be a balance of interests, and a minimum essential level of social rights has to be guaranteed.<sup>7</sup>

<sup>7</sup> Cf. the General Comment given by the Committee on Social Rights on Article 9 of the ICESCR: 'There is a strong presumption that retrogressive measures taken in relation to the right to social security are prohibited under the Covenant. If any deliberately retrogressive measures are taken, the State party has the burden of proving that they have been introduced after the most careful consideration of all alternatives and that they are duly justified by reference to the totality of the rights provided for in the Covenant, in the context of the full use of the maximum available resources of the State party. The Committee will look carefully at whether: (a) there was reasonable justification for the action; (b)

Although this interpretation is not binding and not generally accepted, we can basically confirm that international law obliges States – at least those who have ratified the relevant documents, especially the ICESCR – to address first the needs of the most vulnerable persons, if redistribution of scarce benefits is necessary in an economic crisis. But even if we accept this rule as part of international law, unfortunately, the mechanism set up to enforce it is not effective.

Let us assume a State violates this rule and defines as a political priority the compensation of those who have lost money on bank accounts in State owned banks without having due regard to the needs of the poorest in the country. Such a failure to fulfil the international obligations would be criticised years later in the framework of the regular supervision cycle. There might be a short – diplomatic – remark in the Concluding Observations of the Committee on Economic, Social and Cultural Rights. The State Party would probably be called upon to change its policy. But legally the Concluding Observations are not binding. The control procedure is understood as a dialogue. That means – a State violating its obligations does not have to face serious consequences.

Therefore the whole mechanism is very soft and – ineffective.

*Third, social standards at the national level have had a much greater success story. At least to a certain extent they have helped to smooth out social inequalities and to prevent large-scale misery in the event of economic and financial crisis.*

Contrary to international law, national law can help to avoid disastrous social consequences in the aftermath of a world financial crisis. This can be explained with an example. During the world financial crisis 2008 Germany as an exporting nation suffered big losses in major industrial branches such as the car industry and steel industry. As a consequence of the losses it was

alternatives were comprehensively examined; (c) there was genuine participation of affected groups in examining the proposed measures and alternatives; (d) the measures were directly or indirectly discriminatory; (e) the measures will have a sustained impact on the realization of the right to social security, an unreasonable impact on acquired social security rights or whether an individual or group is deprived of access to the minimum essential level of social security; and (f) whether there was an independent review of the measures at the national level’.

expected that workers would be dismissed and unemployment would rise considerably. Yet, the national legislator could react immediately and guarantee 'Kurzarbeitergeld'. That means that the employers could reduce the working hours and pay proportionally lower salaries. The State paid compensation to the workers. Thus a break-down of the enterprises and a significant rise of the unemployment rate could be avoided at least in the short term; the long-term consequences remain to be seen.

That means that national law can be used as a tool to overcome difficulties resulting out of unexpected crises. It is possible to design flexible, tailor-made measures and to react, if need be, spontaneously.

*Fourth, the transfer of success models from the national level to the international level will rarely have the effects wanted.*

It has always been tempting to transfer ideas and models that have worked out well at the national level onto the international level. One example might be social security. In the 1880s in Germany the so-called Bismarckian model of social security was developed. Thus a system of invalidity and old age pensions, a system of workers' compensation and a health insurance system were set up. This experimental – and at the time very controversial – approach proved to be beneficial to all and was soon developed further including more groups of the population and more branches of social security. At the same time it was copied in other countries.

The insurance model developed at the national level was transposed to the international level and served as an example for several ILO conventions, e.g. on sickness insurance, workers' compensation, old age insurance, invalidity insurance, survivors insurance and unemployment provision. Yet, these conventions were only scarcely ratified. After the Second World War the ILO developed a more comprehensive system that comprised not only the Bismarckian insurance model, but also the Beveridge model. Although it is a flexible instrument and allows for a selection of social risks to be covered it has been ratified by less than 25% of the member States of the ILO. The reasons for this reluctance to accept an international model even if it has proved advantageous at the national level are manifold. The model is based on the needs of a society in a highly industrialised country and does not really address the problems of differently structured societies. It prescribes a model that is not tailor-made for the specific situation in other countries. It is coined by the perceptions of the time and may be understood as too narrow and too rigid from different perspectives.

If transferred to societies living under completely different conditions a success story can quickly turn into a failure. This has been extensively analysed under the slogan of 'transplantation of law'.<sup>8</sup> Nowadays, in legal literature scepticism outweighs optimism in this regard.

*Fifth, there is always a clash of interests in defining international social standards.*

Countries do have different competitive advantages defining their position in world economy. Some can produce high quantities in a short period of time. Some stand out in producing high quality products. Some have specific raw materials for export. Some can manufacture at very low prices.

When setting social standards which define minimum standards for working conditions or minimum standards for a social security net, State parties are always afraid to lose their respective competitive advantages. Generally, it can be said that Asian countries<sup>9</sup> are especially reluctant to subscribe to international social standards. Social standards defining maximum working hours, minimum paid holidays etc. are – at least in the short term – considered as a factor hindering production at low prices. Therefore low-price countries might have an incentive not to subscribe to them. In other countries politicians expect advantages in the domestic power-play if they push for high standards. In the end compromises can be often found only at a very low level. Thus, for example, the complete abolition of child labour is seen to endanger production and survival in some poor countries. Therefore a universal compromise – accepted by 171 countries out of 193 – could only be found in banning the so-called 'worst forms of child labour'.<sup>10</sup>

Divergent interests can also be seen in the conception of gender equality. Whereas in Western countries it is understood to ban all sorts of protective measures that are not directly linked to maternity, developing coun-

<sup>8</sup> See Alan Watson, *Legal Transplants. An Approach to Comparative Law*, 1974; see also the critique of this idea in the writings of Daniel Legrand, *The Impossibility of Legal Transplants*, *The Maastricht Journal of European and Company Law* (1997), p. 111 et seq.

<sup>9</sup> Former Soviet States tend to ratify the conventions, but not to report on them; the whole process does not seem to be taken seriously.

<sup>10</sup> Convention No. 182 of the ILO concerning the Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labour (Date of coming into force: 2000).

tries tend to uphold the more traditional approach allowing for 'protective prohibitions' such as the prohibition of night work for women or the prohibition of underground work for women. The clash can be seen in the attitude towards ILO convention No. 87 on the prohibition of night work for women elaborated in 1948. It was denounced in the 1990s by 21 mostly European countries whereas it is still valid for 25 non-European countries. Therefore it is difficult to define what a 'universally accepted standard' might be in this field.<sup>11</sup>

That means that the different attitudes towards social standards do not only mirror different strategies in economic policy, but also different societal developments as well as different opinions and views on social cohesion and social life.

*Sixth, regional social standards tend not to be very different from universal ones.*

On the basis of the fifth thesis it might be expected that regional standards are very different from universal standards. It might be easier to agree on common standards in less heterogeneous groups of countries. The opposite is true. Europe has the most elaborate system of social standards. Yet, they mostly copy universal standards. Even if higher standards are elaborated, they tend to be applied only on a selective basis.

Quite often we have parallel standards: the International Covenant on Economic, Social and Cultural Rights at the universal level and the European Social Charter at the European level, the ILO Convention of Social Security at the universal level and the European Code of Social Security at the European level. The differences of the basic instruments are marginal. What matters more are further developments. Thus, the European Code of Social Security is complemented by a Protocol defining higher standards. But at the international level there is also a follow-up to the basic standards.

An interesting difference, however, is the design of the control and implementation systems. The difference is especially marked in the field of civil and political rights. Whereas the International Covenant on Civil and Political Rights and the European Convention on Human Rights are simi-

<sup>11</sup> The 'Night Work convention' elaborated as a compromise in 1990 has been ratified only by 11 countries and cannot be called a success story either.

lar, the jurisprudence built up by the European Court of Human Rights cannot be compared to the non-binding conclusions of the Human Rights Committee. In the field of social rights the picture is, however, more complex. For example, the development of the Collective Complaints procedure on the basis of the European Social Charter (Revised) was an innovative approach as it allowed complaints of NGOs or other associations. But for the ILO conventions – at the universal level – we always had similar possibilities. And even the International Covenant on Social and Economic Rights has been complemented by a Protocol on an Individual Complaints procedure, which is expected to enter into force soon.

Yet, regional differences do matter. If regional standards are defined they might be similar to universal ones. But elaborate regional social standards exist only in Europe and in Latin America; in the post-soviet world they are more theoretical than practical. There are no comparable initiatives in Africa, Asia,<sup>12</sup> North America and Canada.

*Seventh, social standards are either too abstract or too concrete.*

The wish ‘to have rules and regulations’ is vague and undefined. The central question is how concrete such standards can be, which obligations they can fix for whom.

It might be easier to define negative standards – to prohibit gender or race discrimination or to prohibit forced labour. But even that is not ‘easy’ if we have a closer look at the respective legal terms. Can the prohibition of race discrimination ban positive action? How can we operate with the notion of ‘race’? In how far is prison labour allowed despite of the prohibition of forced labour?

Social standards are usually not expressed in negative, but in positive terms. Here, too, it is possible to have recourse to very abstract terms, such as the guarantee of the ‘minimum subsistence level’ or the obligation ‘to set up a system of social security’. But does a ‘social security system’ necessarily have to comprise benefits in the case of unemployment? Should support in the case of old age or in the case of sickness have priority? Can the standards worked out for European countries have any meaning for African countries?

<sup>12</sup> A first step can be seen in the Bangalore declaration adopted in 2005. But it does not contain any ‘standards’, but merely calls upon action to solve pressing problems especially in the mega cities.

So we can see that the international social standards oscillate between standards that are too abstract and standards that are too concrete. On the one hand we define the obligation 'to set up a social security system', on the other hand we prescribe exactly what percentage of medical costs has to be replaced in case of sickness. This shows a basic dilemma of international social standards: if they are concrete, they can be applied, but they cannot be applied universally; if they are abstract, they can be applied universally, but nobody really knows what they mean.

*Eighth, law-making at the international level tends to be very bureaucratic, slow and inflexible. The same is true for control mechanisms.*

The list of problems we have to face when defining international social standards is very long. One more difficulty should not remain unmentioned. Law-making at the international level is much more complex and time-consuming than law-making at the national level. We have already talked about the capacity of national law to be used as a tool to react in emergency situations, a capacity international law in the social field, as a rule, does not have.

At the international level the elaboration of new social standards takes on average more than one decade. One depressing example was the revision of the European Code of Social Security. This convention was considered to be outdated as it mirrored the world of work in the 1950s. Therefore in 1973 the expert committee on social security of the Council of Europe stated the necessity to work out a new regulation. A recommendation of the Parliamentary Assembly in 1979 started the process of revision. In November 1990 the new instrument was finally adopted and opened for signature. Up to now (2010) the new revised Code has been ratified only by one country and has therefore not yet entered into force.

It is not difficult to explain why law-making at the international level is so time-consuming. The debate has to integrate not only the governments of 193 States, but also non-State actors such as trade unions, employers associations and non-governmental organisations. Within the framework of the ILO the process of forming an international public opinion has been institutionalised in a balanced form. Yet, this is linked to a huge bureaucracy – for the international labour conference where every year in June about 6,000 delegates of all the member countries come together, about 5,000,000 pages of paper are printed.

The control mechanisms are as bureaucratic and slow as the law-making mechanisms. Here, too, some numbers might illustrate the problems: in 2010 the control committee supervising the implementation of the ILO conventions had to check 2,053 State reports within two weeks time. More than 1,000 reports due were not sent in.<sup>13</sup> As a rule, the reports reflect the legal developments in the five years preceding the control session. Therefore the criticism of the expert committee might be directed against legal regulations or practice that does not exist any more.

Yet, it is easy to criticise. It is much more difficult to develop a more efficient system that does not violate the prerequisites of a fair trial.

*Ninth, international social law might have unexpected positive effects.*

International social standards are set up to be observed and followed. This can imply the change of legislation, the change of judicial practice, the change of orders given by the executive. Cases of progress can be observed if, for example, a certain group excluded from certain benefits is included, a jurisprudence denying certain fundamental rights is given up, a new policy is elaborated to address an important social problem.

International social standards are probably most effective if they are used as an argument in the political debate within a country. A historical example would be the fight for freedom of association in Poland in the early 1980s where ILO standards could serve as point of reference. The same is true for many countries in Latin America where the criticism of the denial of basic social rights is reinforced by international standards. In European countries nowadays it seems that comparative studies of the OECD have more impact if they show social problems in facts and figures.

Yet, international social standards might have surprising 'side-effects' and be more effective than expected. Examples might be self-obligations of big international players polishing up their image by stressing that their policy and philosophy is based on fundamental social rights. Countries such as the United States take international social standards as points of reference in trade agreements or other international treaties although they themselves are reluctant to ratify the relevant conventions.

<sup>13</sup> *Report of the Committee of Experts on the Application of Conventions and Recommendations*, Report III Part 1 (a), Geneva 2010, p. 12.

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It is difficult to measure the development of a 'social conscience' in the globalised world. But it would be short-sighted to neglect the long-term influence of international social standards.

*And that is why I come to my tenth and final thesis: despite all problems and draw-backs it is necessary to continue on the path of determining social standards at the international level.*

## COMMENTS ON PROFESSOR PARTHA DASGUPTA'S PAPER 'FINANCIAL CRISES AND THE WORLD'S POOR'

JANNE HAALAND MATLARY

Professor Dasgupta has written a very important paper on the importance of trust for the economy. Trust is not only vital for the functioning of the economy, but also for politics and life in society in general. This is commonsensical, for how can one conduct any kind of complex interaction unless there is trust in others? Yet the concept of trust is not paid much attention to in discussions of the financial crisis.

One might say that there are two different views of man, one derived from Aristotelianism where the postulate is that man is rational, implying created with an ethical sense, hence being able to live well with others with the *summum bonum* as a goal. On this view, good societies may be achieved. The alternative view is rather Nietzschean: man seeks power and must be strong to survive and dominate others. Such men will only cooperate if they can control that no one cheats. Life is a struggle among beasts, and the state must be a Leviathan. But even in Hobbesian society, enforcement can create a system that can work. A police state is also a state, and a state is better than anarchy. In societies with much trust, there is little need for enforcement, and vice versa.

Professor Dasgupta does not speak about anthropology, but is concerned with the key question of how a functioning financial system can be designed. Starting with some telling statistics about how the financial crisis affects the world's poor, we learn with disconcerting clarity that there is no justice in the world: Sub-Saharan Africa's growth has declined very much due to the crisis, and with its population growth, there is in fact now a *decrease* in growth for these states: 'The poor, as always, have had to carry a proportionate burden of the folly of the rich' (*ibid.*, p. 5).

### 'GREED IS GOOD'?

There is no doubt that the market-liberal model can bring growth and prosperity to developing countries – development economics has many examples of this. Indeed, the incentives of the market are necessary and useful for all societies. There is no better alternative. But it is quite surprising that there is such a belief in the almost total freedom of market systems when in fact human beings are not perfect, but in need of some kind of regulation because temptation to abuse a system for power and/or money is always there.

In politics, therefore, we have many rules that purport to discourage politicians from power abuse. They cannot enrich themselves, provide favours to friends, deviate from the rules, etc. without being found out and punished. Clearly we understand that power carries with it the temptation of corruption.

Likewise, we are as citizens under the rule of law in all aspects of society – we have freedom, but we are also regulated in what we can do. We can be creative and manage our own lives, but the law of the land regulates the outer limits of our behaviour. We obey the law partly because we think it is the done thing – it is normal to be law-abiding – and partly because we will be punished if we break it.

As politicians and as citizens – as well as in our private lives – we think about what is right and wrong, about ethics. Not only the law and its limits form the boundaries of our behaviour, but also norms of ethics. The law is not enough; there is more demanded of us in our private and professional lives as well as in our civic lives: we feel, rightly so, that we must exercise ethical judgement about how we live and conduct our affairs: did I act according to proper professional norms towards my colleague? Did I live up to the standards of the profession? Note that this is not equivalent to saying: did I break the rules that my profession has put in writing and adopted? Ethical demands concern more than that which is covered by positive rules and regulations. Ethical dilemmas and concerns would not arise if rules covered them already.

Likewise, in my private life I must adjust my behaviour for the better from time to time, because I tend to forget to be considerate, think of others, etc. I know what is ethically best and yet do not follow that insight always.

The point here is simple: we are expected to be both law-abiding as well as ethical in all our walks of life. Like the professor or medical doctor who asks himself whether he acts in accordance with general as well as professional ethical standards, so we should expect the financial manager to do

the same. The banker should ask himself: 'Do I have the best interest of my client in mind when I manage his money?' 'Am I frank about the risks?' 'Is my bonus reasonable, given the job I do?'

It is however clear that these questions have not been standard in the financial sector. I am among the many ordinary bank customers that have been utterly shocked by the revelations of greed and dishonesty in this sector. Bonuses have been unrelated to risk, customers have been sold so-called 'investment products' that have been extremely risky, and when banks have been on the brink of bankruptcy, they have asked for government assistance and received it.

Professor Dasgupta advocates that the client-banker relationship should resemble that of the patient-doctor: like the patient trusts the medical expert, the client puts his trust in the financial expert. Like the doctor charges a fee that is regulated by the authorities, so the banker should also have his fees regulated. Like the doctor is regulated by clear professional rules set by the his government, so the financial manager should be regulated by his government.

Yet this is not at all the case. 'Greed is good' has largely become the accepted standard, and it is as if we have become accustomed to a double standard of ethics: one for us, but with an exception for the financial sector. When I grew up in my little hometown in Southern Norway, my family trusted the banker like they trusted the doctor. This was normal there, and there is of course no reason why it should not be.

#### IN TRUST WE TRUST

Professor Dasgupta therefore analyses the over-arching importance of trust: the financial market is of course different from medicine in terms of risk – the trader or banker should earn more when taking more risk, but the client should always know what risk entails, and the trader or banker should not cash in the bonus at once – it should be related to the risk at hand over time. Today the trader is rewarded for short-term success or even for just selling the 'product'. The client assumes the long-term risk alone. This system has obviously benefited the banker or trader and not the client.

In the Norwegian press we just learnt that parking companies that were privatized issued parking tickets even when there was no reason to. There was an enormous incentive to do so because wages for the parking inspectors are related to 'performance', i.e. they get paid more when they

issue more tickets. Furthermore, car owners seldomly protest because it is so very hard to get through the cumbersome system of complaining, and even if they do, it is hard to prove that they had a paid ticket in the car window. There is a power asymmetry between the parking company and the lone car owner.

This story is analogous to many stories from the banking sector in recent years: the client has been told by his banker that this or that 'product' is good for investing his savings in, while the banker's motive has been related to his bonus, often a percentage of the amount invested. The trust has been one-sided, from the client only. An infamous story from Norway concerns municipalities that were persuaded to invest in American derivatives by an investment company, Terra Securities. Terra derived enormous profit whereas the municipalities suffered almost total loss of the money that in fact belonged to their citizens. They went to court on the charge that they had been deliberately misled by the investment company.

Professor Dasgupta is therefore right in pointing to the importance of trust. If now clients have learnt from cases like the above to distrust bankers and investors, we have arrived at a so-called Nash equilibrium, a situation where all actors share the same assumption, viz. that no one dealing with investment can be trusted. The system then becomes self-enforcing in the sense that no one trusts each other, and as such, it breaks down. The client will perhaps put his money in real estate or revert to a barter economy, whereas the banker and investor are out of a job very soon. If no one has any reason to trust the other actors, we have a malign situation where everyone is worse off than if they co-operated. If both clients and bankers lose trust in each other, we are in a situation like the famous Prisoner's Dilemma where both detainees get outcomes that are worse than if they had co-operated.

In the financial crisis, we have had and still have a situation where largely clients have been fooled by bankers and investors; the trust has been one-sided. There has not been a Nash-equilibrium, and by now clients have learnt that they have little or no reason to trust banks. They therefore alter their behaviour if they can, but banks are more powerful and are saved by governments and therefore 'rewarded' for their unethical behaviour. The problem of 'moral hazard' has not been solved and explains why the system can continue even now.

There is clear need for regulation. But regulation at only the national level will not do. There must be international regulation of financial markets if they are to function, but governments are only 'valid' as law givers in

their own territory. They are only responsible to their own citizens. But bankers and investors are global actors that can 'defect' from a given state if they want to. This enhances their power vis-à-vis both clients and governments. They can demand to be saved because of their clients in their home state, but can 'defect' when that becomes advantageous. There is a need for punishment for breaking the rules, but how can this be realised?

As Professor Dasgupta writes, 'trust is maintained by the threat of punishment' (p. 15). This is because actors in a market do not trust each other because they belong to the same family or are friends, but because they believe that in general, one obeys the law and places trust in legal institutions and in society. In many societies there is no trust at all, and then enforcement also fails because it cannot oversee all activity. But in most societies trust is the normal condition – I buy something and I pay for it later when I am billed – I know that unless I pay, there will be rules enforced. The seller also knows this. He trusts me with the commodity I buy and that he will get paid later. Usually legal enforcement is unnecessary, but it acts like a guarantee.

In the financial markets, there is no such enforcement. In addition they are global. We are faced with a very complex problem. Reputation, which is an incentive to be honest and keep promises, may not work in a global system. In a small town a firm's reputation acts as an enforcer of a social norm: in my hometown we know that the plumber and the carpenter will do solid work, because if they don't, the whole town will be informed very soon. They will be shamed, their reputation destroyed, and they will lose customers. The social norm that they do good work is therefore extremely strong. They also take professional pride in this and have never reflected on the 'usefulness' or even 'utility' of being trustworthy. However, if I have to call a plumber or carpenter in Oslo, the capital, I cannot expect this kind of professional ethics at all. I expect to be over-charged; I do not have any reason to trust the company and have to get references and ask around for information. There is in other words total trust in my hometown's carpenter, and very little trust in one from the capital. This example underlines how fantastic trust is for the functioning of an economy or society – it reduces all transaction costs to the minimum. Things function and things are also ethically sound. But when trust is lacking, all sorts of other problems arise.

In game theory we have models that are concerned with 'iteration' and have long 'shadows of the future'. This is how a society is – we live together and interact for a life-time. We meet as citizens, not only as professionals. Therefore the maximisation of self-interested behaviour may pay off only

once, in a game that is not iterated. In the normal state of affairs, such selfish behaviour is punished by others by loss of your reputation and trust in you. If you cheat on your fellows, you must leave town afterwards or live with a tarnished reputation.

The problem with the financial crisis is as said, ethical to the core. But it is very difficult to envision a solution to this problem as long as the financial sector is global. It 'belongs' to a given state only when it needs money from the state; otherwise its actors can move freely and are not obliged to have a reciprocal relationship with their state's clients. How can such an unequal system be regulated and enforced? How can trust be cultivated when the system can be exited by one set of actors? Trust in small communities where we all know each other is possible, but it seems that the nation-state is the upper limit of trust. Outside the state there is no enforcement and no trust.

**HOW DID WE GET TO THIS POINT?  
THE DECISIVE CONTRIBUTING FACTORS**

# RÉFLEXIONS À PROPOS DES EFFETS DE LA CRISE ÉCONOMIQUE MONDIALE SUR LES ENTITÉS ÉTATIQUES ET LES POPULATIONS

LOUIS SABOURIN

Dans son message de Pâques *Urbi et Orbi* du 4 avril 2010, Benoît XVI déclarait que:

Pour sortir d'une crise qui est profonde, l'humanité a besoin non seulement d'ajustements superficiels mais d'une conviction spirituelle et morale. La crise morale que vit notre planète réclame des changements profonds à commencer par celui de la conscience.

Benoît XVI fit ensuite mention des conflits et des catastrophes au Moyen-Orient, en Asie, en Afrique, en Amérique latine et dans les Caraïbes se référant aux séismes en Haïti et au Chili et démontrant ainsi qu'on devrait porter attention aux problèmes qui touchent toutes les régions de l'humanité. Le Saint-Père nous invite à mieux transcender chacun de nos pays, chacune de nos disciplines pour mieux appréhender le sens et les effets de la crise économique actuelle. Je serais porter à dire qu'il nous encourage à allier *science* (connaissance du monde tel qu'il est) et *conscience* (ouverture, respect de l'autre, compassion et solidarité). Il s'agit d'une interpellation d'une portée vraiment planétaire et interdisciplinaire face à trop d'analystes qui se cramponnent sur un aspect de la crise, financière notamment, ou qui se limitent à en analyser les effets seulement dans leur pays ou dans leur région.

Teilhard de Chardin ne déplorait-il pas que 'ce qui est trop souvent déterminant dans la perception du monde' ce n'est pas 'où' l'on regarde, mais bien 'd'où' l'on regarde. La vision du monde, des États et des populations, n'est pas nécessairement la même lorsqu'on l'examine de Paris, de Washington ou de Londres que lorsqu'on l'envisage de Cotonou, de Delhi ou de Port-au-Prince. Ainsi, les perceptions de la crise économique mondiale sont multiples, d'aucuns allant jusqu'à souligner qu'il s'agit certes d'une

crise internationale mais qui échapperait à un nombre important d'États et à des populations dont la situation de survie est si précaire qu'elle ne saurait être concernée par une crise 'd'origine externe'.

Et pourtant, il y a bien crise. Si l'on se réfère à son étymologie latine 'crisis', il s'agirait d'une manifestation grave d'une maladie alors qu'en grec 'krisis' signifie 'une décision', 'un jugement'. Faut-il par conséquent porter un jugement sur une maladie grave? Je crains, et sans jeu de mots, que c'est ce que nous sommes conviés à faire ici.

En fait, le terme 'crise' prend différent sens depuis la crise de conscience à la crise nucléaire et à la crise de croissance; le mot peut être aussi associé à une période difficile de la vie de quelqu'un, à une grave pénurie de quelque chose, à une manifestation violente d'un état morbide survenant en pleine santé apparente, à une rupture d'équilibre entre la production et la consommation. Les crises sont omniprésentes dans nos vies et dans nos esprits: crise familiale, sociétale, géostratégique, démographique, politique, religieuse, économique, financière; notre époque serait en crise. La crise serait en osmose avec notre époque. La terre elle-même, avec tous les séismes récents et les problèmes environnementaux, serait en crise. L'État, on le clame à peu près partout, serait aussi en crise. Bref, la crise serait dans tous ses états... et deviendrait pour d'aucuns un 'état d'esprit'.

Et pourtant, l'Histoire des derniers millénaires n'a pas été un long fleuve tranquille et n'a pas été dépourvue de crises fort sérieuses. Mais qu'est-ce qui caractérise vraiment la présente crise? Je ferai deux observations liminaires avant d'axer mon propos autour des effets de la crise sur les collectivités étatiques et sur les populations.

Première considération: nous assistons présentement à la première vraie crise de la mondialisation ou plus précisément à la première crise de la globalisation. Aucune zone du monde, où le nombre d'acteurs s'est considérablement accru depuis 1945, où les communications, les transports et les marchés sont de plus en plus unifiés, n'a échappé à une forme ou une autre de chocs. Pour reprendre les mots de Lafontaine 'ils ne mourraient pas tous, mais tous étaient frappés...'. Sommes-nous alors en présence, d'une crise *conjoncturelle* ou *structurelle*? Une crise conjoncturelle causée par un dérèglement ou un dysfonctionnement spécifique ou occasionnel, notamment des errements des fonds spéculatifs (*hedge funds*) non réglementés, la construction de montages financiers si complexes que leurs effets auraient échappé à leurs auteurs eux-mêmes, le recours à la spéculation effrénée et aux produits dérivés 'toxiques' comme les *subprimes*, sans oublier le manque de vigilance des banques centrales, des autorités gouvernementales et même

du FMI; d'autre part, s'agirait-il d'un problème *structurel*, une crise du système économique lui-même qui rejoindrait maintenant presque tous les États du monde, y compris la Chine, à l'exception de quelques pays dont la Corée du Nord et Cuba qui vivent d'autres formes de crise.

En fait, depuis environ trente ans, on a laissé se creuser un écart entre la sphère financière et l'économie réelle. La première est aujourd'hui environ cinquante fois supérieure à la seconde. En a découlé une crise de l'endettement qui, après avoir ébranlé le Mexique en 1994, le Japon en 1995, quelques pays asiatiques en 1997 et 1998, la Russie en 1998, le Brésil en 1999 et l'Argentine en 2001, se fait sentir maintenant dans le cœur même de *Wall Street* et de la *City* et d'autres places financières de l'Europe occidentale. Ce qui se passe maintenant en Grèce est une manifestation d'une crise financière qui pourrait se répandre ailleurs en Europe. La crise financière devient à maints endroits une crise économique et de là une crise sociale dont l'augmentation du chômage et les pressions sur la valeur de l'euro sont des signes révélateurs. Les actions du G-20, de l'Union européenne, du FMI et des autorités gouvernementales réussiront-elles à colmater les brèches? Si, d'un côté, j'aimerais en être convaincu, d'un autre côté, je suis persuadé que la crise actuelle a non seulement des dimensions *conjoncturelles* mais aussi *structurelles*, ce qui en fait une problématique fort sérieuse.

La deuxième considération est que nous assistons à une croissance des interdépendances et des crises simultanées c'est-à-dire une crise financière, des déséquilibres macroéconomiques, une crise de l'écologie et de l'environnement et une crise du travail dans plusieurs pays occidentaux. On se rend compte que tous les secteurs sont de plus en plus liés aux autres et ont notamment des effets directs sur les marchés boursiers. Une telle interdépendance n'entraîne pas une réduction de la globalisation – qui ne cesse de croître dans les échanges de toutes sortes et les mentalités – mais démontre que nous avons besoin de nouvelles normes de réglementation, de régulation, de gouvernance internationale et même mondiale selon certains, ce sur quoi je reviendrai dans la conclusion.

## I. EFFETS SUR LES COLLECTIVITÉS ÉTATIQUES

J'aborderai maintenant, brièvement et succinctement, les effets de la crise sur les collectivités étatiques. J'ai choisi intentionnellement de limiter mes propos aux collectivités étatiques car le nombre d'entités et de sociétés (organisations interétatiques, firmes multinationales, associations non-

gouvernementales, mouvements, instances, groupes, etc.) qui ont des actions à caractère international sont tout simplement légions. Et même au chapitre des États eux-mêmes, il est impossible de décrire ici comment les 192 États que comptent aujourd'hui les Nations Unies sont affectés et se comportent en présence de la crise économique internationale. C'est pourquoi j'ai cru sage de placer en annexe les statistiques et les données les concernant. Je me permettrai de faire trois observations à leur sujet.

D'abord, si les États sont égaux en droit international, ils sont loin d'être égaux en économie internationale. Comme le soulignait George Orwell dans *Animal Farm*: *'all are equal but some are more equal than others...'*. Si chaque État a un vote à l'Assemblée générale de l'ONU, cinq d'entre eux ont un veto au Conseil de sécurité. De plus, au FMI et à la Banque mondiale, le 'vote pondéré' est fondé sur la puissance économique des États. Si le groupe du G-7 (devenu le G-8 avec l'admission de la Russie) a tenu les rennes économiques depuis le milieu des années 70, nous assistons depuis quelques années, notamment avec la montée des BRIC (Brésil, Russie, Inde et Chine), à un bouleversement de l'échiquier économique mondial. Ainsi, le G-8 a favorisé l'établissement du G-20 où les pays émergents ont un rôle plus important à jouer dans la prise de décision, notamment en matière économique et financière. Il reste à voir comment le G-20, en particulier les États-Unis et la Chine, se comportera lors de la prochaine conférence qui aura lieu en juin dans la région de Toronto au Canada. Il ne faut pas s'attendre à des changements fracassants en ce qui a trait à ce que j'appellerai l'architecture des manières de faire et de penser l'échelon économique mondial. Certes, le 'consensus de Washington' ne fait plus 'tendance' mais il reste à voir comment ses dix commandements – ainsi dénommés par John Williamson – en matière de stabilisation et de structuration vont être affectés. Ces commandements sont les suivants:

1. La discipline budgétaire
2. La réorientation des dépenses publiques
3. La réforme fiscale
4. La libéralisation financière
5. L'adoption d'un taux de change unique et compétitif
6. La libéralisation des échanges
7. L'élimination des barrières à l'investissement direct étranger
8. La privatisation des entreprises publiques
9. La réforme de la réglementation des marchés pour assurer l'élimination des principales barrières à l'entrée et à la sortie
10. La garantie des droits de propriété

La crise a fondamentalement affecté ce ‘consensus de Washington’ mais on ne peut prévoir comment les pays émergents trouveront des voies différentes dans les manières d’agir sur le plan international. D’ailleurs les piétinements à l’OMC, la frilosité des réformes en cours au FMI et à la Banque mondiale ainsi que l’échec ou le demi-succès de la Conférence de Copenhague sont le reflet du fait que la sortie de crise et la mise en place d’une nouvelle architecture ne sont pas pour demain. Néanmoins, la très grande majorité des États souhaitent, en dépit de la persistance de très grandes inégalités à l’intérieur de leurs propres frontières, que la reprise, certes fragile à maints endroits, s’accélère. Les dernières prévisions du FMI en réconfortent plusieurs. Le tableau suivant en fournit une démonstration:

LES PRÉVISIONS ÉCONOMIQUES DU FMI

Croissance du PIB		
	<b>2010</b>	<b>2011</b>
Monde	+4,2%	+4,3%
Pays développés	+2,3%	+2,4%
États-Unis	+3,1%	+2,6%
Japon	+1,9%	+2,0%
Zone euro	+1,0%	+1,5%
Allemagne	+1,2%	+1,7%
France	+1,5%	+1,8%
Grande-Bretagne	+1,3%	+2,5%
Canada	+3,1%	+3,2%
Économies émergentes	+6,3%	+6,5%
Chine	+10,0%	+9,9%
Inde	+8,8%	+8,4%
Amérique latine	+4,0%	+4,0%
Brésil	+5,5%	+4,1%

Source: AFP.

Les prévisions du FMI contenues dans les récentes 'Perspectives de l'économie mondiale' (avril 2010) soulignent que les pays sont très inégaux devant la croissance et que les mesures d'urgence doivent être entamées en particulier pour combattre la dette publique. Après la récession de 2009, le risque a changé. La perte de recettes fiscales due à la baisse de l'activité à cause de la crise menace de mener, si rien n'est fait, à une explosion de la dette. Selon le FMI, la consolidation budgétaire est de plus en plus devenue la priorité. Les efforts budgétaires devraient expliquer des choix d'autant plus douloureux que le taux de chômage devrait rester élevé en 2010 et 2011, particulièrement dans la zone euro où il se maintiendra aux alentours de 10,5%. On le voit, tous ne sont pas égaux non plus devant la reprise. D'ailleurs, il ne faut pas oublier que pour un très grand nombre d'États, à commencer par tous ceux où prévalent des conflits (plus d'une vingtaine selon le Rapport 2010 de l'International Institute of Strategic Studies de Londres) et par les pays les plus pauvres, notamment en Afrique et en Haïti, la crise économique ne fait qu'aggraver une situation déjà accablante pour une majorité des populations locales.

## II. LES EFFETS SUR LA POPULATION

Vouloir aborder les effets de la crise économique sur les populations représente certes un objectif louable en soi sur le plan théorique ou doctrinal mais presque impossible à mettre en oeuvre sur le plan pratique en se fondant sur des données applicables à chacun des États de la planète. On pourra sans doute le faire dans quelques années. Encore ici, nous faisons face à d'énormes inégalités aussi bien au Brésil qu'aux États-Unis qui sont les champions en la matière. La même chose est maintenant vraie en Chine, en Inde, en Russie ainsi que dans les États du Golfe persique. De nouvelles formes d'inégalités apparaissent dans presque tous les pays industrialisés où le chômage des jeunes et des moins jeunes et l'appauvrissement de personnes âgées sont étroitement liés à la crise économique.

Mais au-delà de la présente crise, il importe de saisir d'emblée des données démographiques mondiales qui ont affecté l'évolution des relations internationales au cours du siècle dernier et qui, à mon avis, deviendront de plus en plus déterminantes à l'avenir, compte tenu du vieillissement des populations dans les pays riches et de l'explosion démographique dans les pays moins favorisés, de la mobilité croissante des populations, de la désintégration des cultures traditionnelles, de la menace d'épuisement des ressources énergétiques et probablement des changements climatiques.

## PROGRESSION DE LA POPULATION MONDIALE

1800	1 milliard	-
1930	2 milliards	130 ans
1960	3 milliards	30 ans
1975	4 milliards	15 ans
1987	5 milliards	12 ans
1996	6 milliards	11 ans
2010	7 milliards	14 ans
2020	8 milliards?	10 ans?
2030	9 milliards?	10 ans?
2040	10 milliards?	10 ans?
2050	11 milliards?	10 ans?

Ce tableau est impressionnant en lui-même mais évidemment approximatif en ce qui a trait au long terme. De plus, il ne dit rien quant à la répartition de cette population, ce que l'on pourra voir dans le document placé en annexe. Un premier fait saute aux yeux: l'Asie concentre la plus importante part de la population. Six pays sur 192, la Chine, l'Inde, l'Indonésie, le Bangladesh, le Vietnam et le Pakistan (on pourrait ajouter le Japon) représentent à eux seuls près de la moitié de la population mondiale. Un second point: l'Afrique au Sud du Sahara qui ne comptait que 250 millions de personnes, il y a moins de cinquante ans, en aura bientôt un milliard.

Voilà deux réalités démographiques, parmi bien d'autres, qui risquent d'avoir des conséquences énormes non seulement sur les plans stratégiques et économiques mais aussi sur les plans éthique et moral, ainsi que sur nos perceptions des perspectives du 'développement' et du 'mal-développement', notions qui, à mes yeux, devraient être complètement repensées.

## CONCLUSION

J'en viens à ma conclusion qui soulèvera brièvement deux points fondamentaux. Dans la conclusion de son récent ouvrage *Freefall: America, Free*

*Markets, and the Sinking of the World Economy*, notre collègue Joseph Stiglitz souligne que la crise économique, en particulier aux États-Unis, *is more than just a matter of plumbing: the failures in our economic financial system are emblematic of broader failures in our economic system and the failures of our economic system reflect deeper problems in our society.*

Il termine son ouvrage en écrivant:

*The poor countries simply can't back up their enterprises as the rich do, and this alters the risks that they can undertake. They have seen risks of globalization badly managed. But the hoped-for reforms in how globalization is managed still seem distant horizon.*

En effet, en présence, d'une part, d'une *mondialisation économique en croissance*, nous faisons face, d'autre part, à un *déficit en matière de mondialisation politique*. Certes les motifs de pessimisme sont nombreux. Saura-t-on, au G-20, maîtriser les interdépendances que j'ai évoquées plus tôt? Pourra-t-on établir des normes contraignantes acceptées par tous? C'est sans doute plus qu'un vœu; il s'agit bien d'une nécessité; cependant, les intérêts nationaux demeurent très vivaces et constituent des freins à une mise en œuvre rapide et coordonnée d'une nouvelle architecture financière, économique et politique à l'échelon mondial. Bien que je ne partage pas du tout les visions catastrophistes de nombreux analystes, j'aimerais toutefois être plus optimiste.

Plusieurs décennies d'étude et de pratique de la vie internationale m'incitent à penser que la fuite en avant perpétuelle, propulsée par un modèle de développement défini par la Banque mondiale dans l'immédiat après-guerre et fondé sur le revenu *per capita*, modèle que les pays en développement ont presque tous adoptés, ne peut ni à courte, ni à longue échéance apporter des solutions vraiment satisfaisantes à la quête d'un mieux-être plus généralisé, notamment dans les pays les plus défavorisés.

Entre la recherche d'un *Bonheur national brut* que seul le Bhoutan a réussi à proposer de manière bien singulière et un *niveau de vie* principalement axé sur le *revenu per capita*, il existe sûrement des voies alternatives pour définir un *genre de vie* et un *mieux-être* où l'équité, la compassion et la solidarité trouveraient aussi leur place. Plusieurs institutions, à commencer par l'OCDE, divers gouvernements ainsi que d'autres entités et observateurs tentent depuis quelques années de définir les composantes et les critères d'un tel mieux-être. L'Académie pourrait sans doute participer à cette quête puisque celle-ci s'inscrit pleinement dans la poursuite de ses objectifs.

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ANNEXES

# Population 2008

Classement des populations de la plus importante à la plus faible, des 232 pays du monde, en habitants. Estimations dérivées.

Rang/Pays	Population	Rang/Pays	Population	Rang/Pays	Population	Rang/Pays	Population
1 Chine	1 328 620 000	88 Angola	17 318 000	177 Brésil nord-est	5 157 000	176 Bahamas	328 000
2 Inde	1 139 080 000	89 Chili	16 737 000	178 Émirats	5 108 000	177 Islande	318 500
3 États-Unis	304 572 000	90 Pays-Bas	16 616 000	179 Inde	4 473 000	178 Belize	310 500
4 Indonésie	230 215 000	91 Kazakhstan	15 665 000	180 Tchad	4 441 000	179 Maldives	310 400
5 Brésil	193 095 000	92 Corée	15 161 000	181 Émirats	4 421 000	180 Émirats	295 000
6 Pakistan	165 999 000	93 Arabie Saoudite	14 699 000	182 Thaïlande	5 361 000	181 République centrafricaine	280 000
7 Bangladesh	161 174 000	94 Niger	14 661 000	183 Nouvelle-Zélande	4 372 000	182 République centrafricaine	240 400
8 Nigeria	141 283 000	95 Malaisie	13 754 000	184 Liban	4 137 000	183 Yémen	231 500
9 Iran	141 791 000	96 Guatemala	13 671 000	185 Panama	4 062 000	184 Guyane française	211 500
10 Japon	127 786 000	97 Zimbabwe	13 575 000	186 Porto Rico	3 950 000	185 Antilles néerlandaises	187 200
11 Mexique	106 345 000	98 Émirats	13 499 000	187 Libéria	3 951 000	186 Nigeria	186 500
12 Philippines	95 460 000	99 Venezuela	12 751 000	188 Corée	3 855 200	187 Samoa occidentales	182 200
13 Vietnam	86 179 000	100 Mali	12 705 000	189 Maldives	2 773 200	188 Oman	175 400
14 Allemagne	82 160 000	101 Jamaïque	12 146 000	190 République tchèque	2 767 500	189 Islande	187 000
15 Éthiopie	80 956 000	102 Cuba	11 203 000	191 Panama	2 591 500	190 Îles Turcs et Caïques	160 000
16 Egypte	76 766 000	103 Ouzbékistan	11 338 000	192 Liban	3 552 300	191 Anglo-Normandes (Gu.)	149 500
17 Turquie	74 004 000	104 Tchad	11 062 000	193 Uruguay	3 223 300	192 Saint-Vincent	120 900
18 Iran	71 950 000	105 Belgique	10 704 000	194 Montserrat	2 199 300	193 République	111 200
19 République	68 222 000	106 Portugal	10 624 000	195 Albanie	2 191 200	194 République	100 300
20 Congo (ex-Franç.)	64 180 000	107 Togo	10 339 000	196 Argentine	2 099 500	195 République	100 700
21 France	61 872 000	108 Tunisie	10 223 000	197 Kenya	2 721 200	196 République	100 600
22 République	61 399 000	109 Hongrie	10 080 000	198 République	2 697 300	197 République	100 600
23 Italie	60 910 000	110 Rwanda	10 011 000	199 Oman	2 651 300	198 République	100 600
24 Myanmar	56 910 000	111 République	9 673 000	200 Malaisie	2 622 000	199 République	100 600
25 République	49 100 000	112 Iran	9 779 000	201 Libéria	2 604 000	199 République	100 600
26 République	49 725 000	113 République	9 673 000	202 République	2 137 000	200 République	100 600
27 République	49 725 000	114 République	9 673 000	203 République	2 137 000	201 République	100 600
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29 République	49 725 000	116 République	9 673 000	205 République	2 137 000	203 République	100 600
30 République	49 725 000	117 République	9 673 000	206 République	2 137 000	204 République	100 600
31 République	49 725 000	118 République	9 673 000	207 République	2 137 000	205 République	100 600
32 République	49 725 000	119 République	9 673 000	208 République	2 137 000	206 République	100 600
33 République	49 725 000	120 République	9 673 000	209 République	2 137 000	207 République	100 600
34 République	49 725 000	121 République	9 673 000	210 République	2 137 000	208 République	100 600
35 République	49 725 000	122 République	9 673 000	211 République	2 137 000	209 République	100 600
36 République	49 725 000	123 République	9 673 000	212 République	2 137 000	210 République	100 600
37 République	49 725 000	124 République	9 673 000	213 République	2 137 000	211 République	100 600
38 République	49 725 000	125 République	9 673 000	214 République	2 137 000	212 République	100 600
39 République	49 725 000	126 République	9 673 000	215 République	2 137 000	213 République	100 600
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73 République	49 725 000	160 République	9 673 000	249 République	2 137 000	247 République	100 600
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125 République	49 725 000	212 République	9 673 000	301 République	2 137 000	299 République	100

# PNB global 2007

Classement des PNB, du plus pauvre au plus riche, des 231 pays du monde, en milliards de dollars (PNB total du monde: 56608,10)

Pays/Pays	PNB global	Pays/Pays	PNB global	Pays/Pays	PNB global	Pays/Pays	PNB global
1 Pays-Bas	520,26	17 Thaïlande	1 026,07	32 Iran	332,00	67 Afrique	104,49
2 États-Unis	14 807,18	18 Chine de Sud	871,19	33 Iran	332,00	68 Émirats arabes unis	103,92
3 France	2 390,18	19 Vietnam	702,23	34 Émirats arabes unis	274,14	69 Philippines	102,09
4 Royaume-Uni	2 021,95	20 Pays d'Europe	646,34	35 Indonésie	256,10	70 Singapour	100,28
5 Italie	1 630,34	21 Turquie	461,04	36 Thaïlande	227,28	71 Malaisie	98,13
6 Inde	1 090,67	22 Arabie saoudite	461,07	37 Australie	206,44	72 Chine	96,84
7 Espagne	1 079,04	23 Belgique	413,27	38 Brésil	216,88	73 Pakistan	95,49
8 Canada	1 010,10	24 Espagne	413,66	39 Portugal	211,11	74 Mexique	93,60
9 Russie	1 271,37	25 France	396,27	40 Pérou	211,11	75 Égypte	92,60
10 Chine	1 316,18	26 Nouvelle-Zélande	306,80	41 Colombie	199,08	76 Israël	92,60
11 États-Unis	1 371,44	27 Corée du Sud	304,59	42 Malaisie	192,72	77 Argentine	92,60
		28 Australie	304,59	43 Israël	144,60	78 Nouvelle-Zélande	92,60
		29 Danemark	317,21	44 Roumanie	108,18		

Pays (Néerlandais)	PNB global						
101 Pays	98,63	106 Émirats arabes unis	44,33	121 Émirats arabes unis	11,32	136 République centrafricaine	15,45
102 République centrafricaine	99,71	107 République centrafricaine	42,44	122 République centrafricaine	11,32	137 République centrafricaine	15,45
103 République centrafricaine	16,18	108 République centrafricaine	41,68	123 République centrafricaine	11,32	138 République centrafricaine	15,45
104 République centrafricaine	79,57	109 République centrafricaine	38,28	124 République centrafricaine	10,69	139 République centrafricaine	15,45
105 République centrafricaine	71,77	110 République centrafricaine	38,10	125 République centrafricaine	10,61	140 République centrafricaine	15,45
106 République centrafricaine	71,81	111 République centrafricaine	36,43	126 République centrafricaine	10,61	141 République centrafricaine	15,45
107 République centrafricaine	46,78	112 République centrafricaine	34,49	127 République centrafricaine	10,61	142 République centrafricaine	15,45
108 République centrafricaine	46,78	113 République centrafricaine	34,49	128 République centrafricaine	10,61	143 République centrafricaine	15,45
109 République centrafricaine	46,78	114 République centrafricaine	34,49	129 République centrafricaine	10,61	144 République centrafricaine	15,45
110 République centrafricaine	46,78	115 République centrafricaine	34,49	130 République centrafricaine	10,61	145 République centrafricaine	15,45

Pays (Néerlandais)	PNB global						
111 République centrafricaine	46,78	116 République centrafricaine	34,49	131 République centrafricaine	10,61	146 République centrafricaine	15,45
112 République centrafricaine	46,78	117 République centrafricaine	34,49	132 République centrafricaine	10,61	147 République centrafricaine	15,45
113 République centrafricaine	46,78	118 République centrafricaine	34,49	133 République centrafricaine	10,61	148 République centrafricaine	15,45
114 République centrafricaine	46,78	119 République centrafricaine	34,49	134 République centrafricaine	10,61	149 République centrafricaine	15,45
115 République centrafricaine	46,78	120 République centrafricaine	34,49	135 République centrafricaine	10,61	150 République centrafricaine	15,45

Pays (Néerlandais)	PNB global						
116 République centrafricaine	46,78	121 République centrafricaine	34,49	136 République centrafricaine	10,61	151 République centrafricaine	15,45
117 République centrafricaine	46,78	122 République centrafricaine	34,49	137 République centrafricaine	10,61	152 République centrafricaine	15,45
118 République centrafricaine	46,78	123 République centrafricaine	34,49	138 République centrafricaine	10,61	153 République centrafricaine	15,45
119 République centrafricaine	46,78	124 République centrafricaine	34,49	139 République centrafricaine	10,61	154 République centrafricaine	15,45
120 République centrafricaine	46,78	125 République centrafricaine	34,49	140 République centrafricaine	10,61	155 République centrafricaine	15,45



## REFLECTIONS ON MODERNITY AND RELATIONALITY

HELEN ALFORD

The problem of the individualistic model of the human being used in the social sciences has occupied this Academy for some years, and rightly so, given its importance.<sup>1</sup> Since some of the relevant aspects of these discussions have been brought into the Academy's considerations in the current volume on the economic crisis, this text, which began as a response to the main papers, starts from this problem and considers how it relates to modernity itself.

It is a commonplace to regard the French Revolution as one of the key moments in the arrival of the modern period. The threefold cry 'liberté, égalité, fraternité' has become inextricably linked with this set of events, for, although at the time many slogans and rallying cries circulated, this one eventually emerged as the synthesis of them all.<sup>2</sup> This seems to put relation-

<sup>1</sup> One volume focused especially on this issue: *Conceptualization of the Person in Social Sciences*, Eleventh Plenary Session, 18-22 November 2005, Acta 11, eds. E. Malinvaud and M.A. Glendon, Vatican City, 2006; others that have also dealt with it include: *Work and Human Fulfilment*, Pontifical Academy of Social Sciences, May 2003, eds. E. Malinvaud and M. Archer, Sapientia Press of Ave Maria College, 2003; *Vanishing Youth? Solidarity with Children and Young People in an Age of Turbulence*, Twelfth Plenary Session, 28 April – 2 May 2006, Acta 12, eds. M.A. Glendon, P.P. Donati, Vatican City, 2006; *Pursuing the Common Good: How Solidarity and Subsidiarity can Work Together*, Fourteenth Plenary Session, 2-6 May 2008, Acta 14, eds. M. Archer and P.P. Donati, Vatican City, 2007.

<sup>2</sup> We should note that among these many slogans circulating at the time of the Revolution, examples abound where the term 'fraternity' has been dropped altogether, leaving only liberty and equality (or two similar terms). For example, on August 25 1790, Mirabeau addressed the National Assembly saying: 'the influence of a nation that...has reduced the art of living to the simple notions of liberty and equality – notions endowed with irresistible charm for the human heart, and propagated in all the countries of the world – the influence of such a nation will undoubtedly conquer the whole of Europe for Truth, Moderation and Justice, not immediately perhaps, not in a single day...' (as quoted in Norman Davies, *Europe: A History*, Pimlico, London, 1996, p. 675). See also the contribution of Margaret Archer to this volume, p. 11 of 20.

ship, symbolised by the word 'fraternity', on a par with liberty and equality, two ideas that fit very well with a purely individualistic view of the human being, even if fraternity is the last term of the triptych. And yet, only the first two have been carried forward and structured into subsequent political and economic projects, hence the need for a reconsideration of fraternity today.<sup>3</sup>

We know well that 'Liberty' has been the basic value of the liberal politico-economic model, where the market is a key mechanism that should be allowed to find its own equilibrium, thereby promoting maximum freedom. 'Equality' has been emphasised by the socialist movements, for whom real freedom is not possible without access to a minimum of economic goods, leading them to favour government intervention in redistributing income and wealth. Fraternity has not been carried forward by either movement, unless we allow the promotion of 'class solidarity' in socialism to be some kind of reflection of it (even if it is not the same thing, not least because such solidarity is aimed against those of a different class), or, on the liberal side, if we note the volunteering that one finds, for instance, in the US (though again, this has not lead liberal thinkers to take fraternity seriously in their theories).<sup>4</sup>

Having noted, therefore, that both these politico-economic projects have difficulty in incorporating fraternity into their theoretical schemes, we may go on to note further that, partly for this reason, liberalism and socialism are only alternatives in a limited sense. Indeed, more profoundly, they are bedfellows, and indeed, at least to some degree, historically as well as intellectually, the socialist movements were born out of the side of the liberal ones.<sup>5</sup> Both liberalism and socialism share a fundamental concern with liberty understood as 'freedom from'; they differ, instead, on the less fundamental level of how to achieve this freedom.

<sup>3</sup> As encouraged by *Caritas in Veritate*, (nn. 19-20; 34-37) and witnessed to in the recent literature regarding, for instance, the 'civil economy'; for a good starting point, see Luigino Bruni and Stefano Zamagni, *Civil Economy: Efficiency, Equity, Public Happiness*, Peter Lang, 2007.

<sup>4</sup> For current information on volunteering in the US, see the web site: <http://www.volunteeringinamerica.gov> (last accessed 12.08.10).

<sup>5</sup> Two from many possible articles on this question, one very recent and another dating back to 1890, are Edward Rooksby, 'The Relationship between Liberalism and Socialism', paper for the PSA conference, Edinburgh, March 2010, available at: [www.psa.ac.uk/journals/pdf/5/2010/744\\_451.pdf](http://www.psa.ac.uk/journals/pdf/5/2010/744_451.pdf) (last accessed 12.08.10) and E. Belfort Bax, 'Liberalism versus Socialism', a Lecture delivered in the Conference Room of the National Liberal Club, November 1890, available at: [www.marxists.org/archive/bax/1890/11/libvssoc.htm](http://www.marxists.org/archive/bax/1890/11/libvssoc.htm) (last accessed 12.08.10).

We may note here that we can find parallels to this partial opposition combined with a more fundamental communality, where supposedly different and competing theories turn out to be more alike than dissimilar, in fields of thought that bring us closer to the economic crisis. In business ethics, for instance, or in the discussion of the social responsibility of business, the 'shareholder' and 'stakeholder' views of the firm are often presented as opposed to each other. In the first case, the purpose of the business is seen to be the maximisation of the value of the investment of shareholders in the company, whereas in the second case, the 'stakes' of all those somehow 'invested' in the company have to be taken into account.<sup>6</sup> While this second theory may give us the possibility of recognising the contribution of various groups to the business and the need to take their interests into account in decision-making, it may not necessarily make any difference at a more fundamental level, that is, to our view of the final purpose of the business. It is quite possible that those attempting to implement stakeholder theory in their management use it to maximise profit for the stakeholders as a whole, rather than just the shareholders. In such a case, the underlying purpose, towards which all other goods are instrumentalised (including the development of human beings in their work), is to maximise profit. In the form that they are usually presented, therefore, shareholder and stakeholder theory, like liberalism and socialism, are less different than they might at first seem. They are only clearly opposed at an intermediate level, in deciding who should be taken into account when running a business, but not necessarily at the level of ends.<sup>7</sup>

If we may return to the comparison between liberalism and socialism, we may say that, seen like this, it is not at all surprising that 'lib-lab' systems could develop, to use Pierpaolo Donati's terminology, since both the 'lib' and the 'lab' are two sides of the same coin, two children of the same mother, two expressions of the same fundamental worldview.<sup>8</sup> As Margaret

<sup>6</sup> The first articulation of this theory can be found in R. Edward Freeman, *Strategic Management: A Stakeholder Approach*, Boston: Pitman, 1984. Freeman's most recent synthesis of his approach is R. Edward Freeman *et al.*, *Stakeholder Theory: The State of the Art*, Cambridge, Cambridge University Press, 2010.

<sup>7</sup> For a discussion of this and other problems with stakeholder theory, see H. Alford, 'Stakeholder Theory', *OIKONOMIA: Journal of Ethics and Social Sciences*, giugno, no. 2, 2007, pp. 25-32, available at: [www.okonomia.it](http://www.okonomia.it) (last accessed 17.07.10).

<sup>8</sup> See the contribution of Pierpaolo Donati to this volume, p. 138.

Archer also reminds us in this volume, collectivism is not the opposite of individualism, or, at least, they are only partially opposites.<sup>9</sup> Donati has demonstrated that the 20th century history of Western Europe and North America has shown amply that these two systems can co-exist relatively easily. Both are in crisis, or perhaps it is their combination that is so.<sup>10</sup>

So what happened to fraternity? Why did it drop out of view? Speakers in our conference have mentioned some of the reasons why it was not taken forward; I summarise two of them here:

- Individualism in modern thought makes fraternity difficult to conceive, since relationships of individuals are instrumental towards obtaining individual objectives. The idea of fraternity is either reduced to this level or, more likely, just dropped out altogether, since it does not really add anything;<sup>11</sup>
- Creating mathematical models in which preferences and final objectives are not just individual but also held in common is much more difficult than if we limit objectives and preferences to being individual only.<sup>12</sup>

The discussion so far, then, may lead us to a question: can we say that fraternity is a part of the ‘modern project’, or of ‘modernity’, or not? Or, to put it another way around: do we need to propose an alternative politico-socio-economic project to modernity, one that takes fraternity seriously? The contributors to this volume who have mentioned this issue have opted decidedly for a positive response to the second question (Donati in particular). But can an argument be made for the opposite answer?

If fraternity is there ‘in the beginning’, so to speak (even if somewhat uncertainly) – if it is a part of the ‘logos’ of modernity – would it not be possible to recover or rediscover the full inspiration behind modernity? Could this not be seen as to propose a *truly modern* project? On this line of argument, it is not with modernity in itself that we should take issue, but with the ways in which it has been concretely realised in history. This approach, which could perhaps be immediately criticised as splitting hairs, should not be dismissed so lightly if we remember that just this type of argument has been used to defend the impact of Christianity in Western society by a figure none other than G.K. Chesterton: ‘the Christian ideal has not been tried

<sup>9</sup> See the contribution of Margaret Archer to this volume, p. 118.

<sup>10</sup> See the contribution of Pierpaolo Donati to this volume, p. 138.

<sup>11</sup> See the contribution of Margaret Archer to this volume, p. 118.

<sup>12</sup> See, for instance, the contribution of Stefano Zamagni to this volume, p. 296.

and found wanting; it has been found difficult and left untried'.<sup>13</sup> Chesterton here aims to defend the Christian project against detractors who say that it has co-existed in society with all kinds of evils: slavery, oppression of women, torture and so on. Is it possible to paraphrase Chesterton, and thus to suggest that it is not that modernity has been tried and found wanting, but that it hasn't been tried? Maybe even these two affirmations could be connected to each other. At any rate, there would seem to be at least some basis for this position. One third of the 'trinity' of ideas that, over time, became associated to modernity in a fundamental way has not found its place in the way the modern project has been worked out concretely, or perhaps even half has been excluded, if we make the argument that freedom and equality, as they have been understood up to now, are two sides of the same individualistic coin. We may go back to the example of the volunteering; it seems that at least incipient forms of fraternity can develop within modernity on the practical level, even if the theory behind modernity has not developed enough to deal with this properly.

One advantage of this way of thinking is that it avoids any connection with postmodernism or any of the numerous other 'after' or 'post' projects. Many of these seem to be more an exasperation of modernity rather than any genuine alternative, presupposing the same individualistic *weltanschauung*. On this reading, post-modernity is to modernity what socialism is to liberalism or what stakeholder theory is to shareholder theory. But postmodernism presents more problems for Christian social ethics than modernism. Above all, the frequent attacks of its proponents on our ability to reason together, and their common assertion that any shared rational foundation for discourse and argument is nothing more than the result of power structures in society, makes these approaches inimical to any project to be proposed here. Despite all the problems that the Church has had with modernity, it is still possible (as Maritain and others have argued) to see it as an offspring of the impregnation of Western culture with Gospel values.<sup>14</sup> The anti-rational element in postmodernism makes it harder to see any such connection between it and the Christian tradition.

<sup>13</sup> G.K. Chesterton, *What's Wrong with the World*, London, 1910, chapter 1, part 5, available at: [en.wikisource.org/wiki/What%27s\\_Wrong\\_with\\_the\\_World/Chapter1.5](http://en.wikisource.org/wiki/What%27s_Wrong_with_the_World/Chapter1.5) (last accessed 17.07.10).

<sup>14</sup> See, for instance, various of the chapters in the collection of articles by Jacques Maritain brought together in the book (in its English version), *Christianity and Democracy*, Geoffrey Bles, 1947.

One of the practical ways in which there has been an attempt to introduce fraternity into modern society has been through the philosophy, and, to a greater or lesser extent, the practice of Christian Democracy.<sup>15</sup> Although more or less absent from the English-speaking world, and seemingly largely exhausted elsewhere, there is no mistaking the parallels between the thinking behind the Christian democratic movements and the kind of proposals that are being made in this volume to rediscover or replace modernity. Christian Democratic parties have tried to develop policies that start from a relational view of the human being. Empirical work on welfare policy, such as that of Kees van Kersbergen on welfare systems in countries with significant Christian Democratic parties from the 1960s onwards, indicates that while spending levels were similar to those of countries dominated by social democratic models, the quality of that spending was different. In his 1995 book (some of which is updated in another book on a similar theme published in 2009), van Kersbergen looks at data from the 1960s to the 1980s, and can say: 'As expected, Christian Democracy is positively related to family-bias in the tax-benefit regimes, whereas social democracy is not'.<sup>16</sup> Also interesting is a preference for systems with diverse sets of benefits, allowing for more personal contribution on the part of those able to afford it, than for the more standardised systems favoured by the social democrats.

Connecting the interesting proposals that have been made here with Christian Democracy is both encouraging and salutary. Encouraging, because some of the most successful parties of the postwar period in Western Europe have based their policies on a relational human being – already trying to do in practice what we are discussing theoretically here.<sup>17</sup> But the connection is also salutary, since we know that these par-

<sup>15</sup> For a good introduction to the key philosophical ideas behind Christian Democracy, and how they differ from those of other parties, see Kees van Kersbergen, 'The Distinctiveness of Christian Democracy' in David Hanley (ed.), *Christian Democracy in Europe: A Comparative Perspective*, London, Pinter, 1994, pp. 31-47.

<sup>16</sup> Kersbergen, Kees van, (1995), *Social Capitalism: A Study of Christian Democracy and the Welfare State*, London, Routledge., p. 139). See also Kees van Kersbergen and Philip Manow (2009), *Religion, Class Coalitions, and Welfare States*, Cambridge, CUP.

<sup>17</sup> On the success of Christian Democracy in Europe, see Wolfram Kaiser, *Christian Democracy and the Origins of the European Union*, Cambridge, CUP, 2007, esp. chp 5, 'Hegemony by Default: Christian Democracy in postwar Europe', pp. 163-190; David Hanley, 'Introduction: Christian Democracy as a Political Phenomenon' in David Hanley (ed.), *Christian Democracy in Europe: A Comparative Perspective*, London, Pinter, 1994, pp. 1-11.

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ties were only partly successful, and indeed, with the exception of Germany, are currently experiencing great difficulty, and not only because of secularisation. Perhaps, however, that difficulty has been in no small measure to do with the lack of economic or sociological theories that could have supported their ethico-philosophical and political commitments, preventing them from offering a real, practical alternative to the dominance of liberal economic and social theories. If this is the case, then the work in this volume could be instrumental in breathing new life into what has been an impressive movement, or in creating new and different forms of it where it has never yet existed.

# LESSONS FROM THE CRISIS<sup>1</sup>

HANS-WERNER SINN

## FIRE PROTECTION IN THE JUNGLE

The US banking system is largely bankrupt and can no longer function without government aid. Its system of mortgage finance has now a strong socialist taste, with government agencies covering almost 95 per cent of the mortgage securitization market. Western Europe's banks are tarnished. Without government money, many of them would fail to meet the regulatory minimum equity ratios and would have to fear withdrawal of their banking licences. Some European banks are even running the risk of losing their entire equity. Even the Swiss banking system, for many the epitome of stability and solidity for decades, would have been doomed without government support. More and more East European countries are tottering and must be saved by international support programmes. If national bankruptcies and related social unrest are to be averted, rescuing them cannot be avoided. At their London summit, the G-20 countries made the necessary funds available for the IMF.

The disaster happened because the bacillus of limited liability, non-recourseness, and irresponsibility spread throughout the world, infecting the financial markets without the regulatory bodies doing anything to stop it. Banks, hedge funds, special purpose entities, investment funds, and real-estate financiers were able to do business almost without any equity. Those having no equity are not liable, and if not liable, they feel free to gamble.<sup>2</sup>

<sup>1</sup> This text has been taken from Chapter 11 of my book *Casino Capitalism. How the Financial Crisis Came About and What Needs to Be Done Now*, forthcoming with Oxford University Press, Summer 2010.

<sup>2</sup> See H.-W. Sinn, *Ökonomische Entscheidungen bei Ungewißheit* (Mohr Siebeck, Tübingen, 1980), esp. 172-92 (Dissertation, accepted by University of Mannheim in 1977, English edition: *Economic Decisions under Uncertainty* [North-Holland, Amsterdam, 1983], esp. 163-82).

They will look for risk wherever it can be found, because they can privatize the profits and socialize the losses. By cutting off part of the loss distribution, they can conjure returns out of mere risk. Even if they finance projects that do not return true economic risk premiums, they still turn a tidy business profit. The dream returns that bankers generate in good times are to a large extent nothing but the mirror image of the losses to creditors and taxpayers who will have to foot the bill if catastrophe strikes.

Non-recourse financial products, from mortgage-backed securities (MBSs) to the multi-stage collateralized debt obligations (CDOs), all of them derivatives of the claims of the mortgage financiers against homeowners, or more precisely against their houses, were part of the roulette game that Wall Street played with the world. Again the business model was based on limited liability. The American banks sold credit claims to the world without having to take responsibility for those claims being honoured. The 1.9-trillion-dollar market for annual new private issues of MBSs and CDOs, produced by means short of alchemy, has vanished in the smoke of the crisis. The casino's main ballroom has had to close after being gutted by fire.

Even American homeowners became gamblers, on the back of the non-recourse mortgage loans extended to them. They dared to get involved in projects that they would not have touched under European liability law. Because they knew that they would be able to get off the hook in the event of house prices falling by sending jingle letters to the bank, they did not shy away from high house prices and so fuelled the American housing boom. Unscrupulous mortgage lending, forced upon the banks by the government to fight the so-called red lining, helped even poorer Americans dream Franklin Roosevelt's dream of general prosperity and widespread homeownership. When they awoke they found themselves in a burning jungle.

Whereas the Chicago or Manchester economics school has disgraced itself, more moderate and prudent interpretations of capitalism such as those proclaimed in Europe now appear much more reasonable. Neo – or ordoliberalism, as formulated by Alexander Rüstow, Wilhelm Röpke, or Walter Eucken, stands out. The central thesis of ordoliberalism was that markets can only unfold their beneficial effects if the government sets the rules of the game. There is no such thing as a self-regulation of markets, only self-ordering within a firm regulatory framework set by the state. The liability principle is one of the fundamental principles of

the market order that Eucken wanted defined and enforced by the state.<sup>3</sup> The collapse of the financial capitalism edifice as a result of this constituting principle being undermined poignantly confirms his thesis.

The banking system can only regain stability if the principle of liability is once again given more recognition. Much stricter capital regulation and the limitation of non-recourse loans are among the essential barriers against gambling that politics must erect. These barriers will create new confidence in the markets for long-term credit contracts and allow capitalism to continue increasing the wealth of the masses. Eucken must go to America!

But before Eucken arrives there, Keynes must save the banks and the economy. Although the ordoliberal recipes serve to protect the jungle from an outbreak of fire, they are less effective in putting out fires that have already been ignited. There may possibly even be a contradiction between measures that create long-term stability and those aimed at battling acute threats, because expectations of government aid if a crisis should strike generate carelessness in dealing with risks. It may also be the other way around, however, that there is indeed a harmonious relationship between the short-term and long-term goals of economic policy.

#### LIQUIDITY, SOLVENCY, AND EQUITY GIFTS

Many people see the biggest present danger for the international financial system in the illiquidity of the banks and in the breakdown of maturity transformation. The liquidity shortfalls of the banks, resulting from the collapse of the interbank market, were indeed the most urgent and initially most visible sign of the crisis. But the liquidity crisis was only the symptom of a much deeper solvency crisis, whose cause was the chronic undercapitalization of the banking system and the capital losses during the crisis. By 31 January 2010, the American banks had already lost more than half of the equity capital they had before the crisis, and they were likely to lose at least another one-fourth. Similarly, by mid-summer 2009 the West-

<sup>3</sup> W. Eucken, *Grundsätze der Wirtschaftspolitik*, 1st edn. (Francke und Mohr, Bern, 1952), here cited according to the 7th edn. (Mohr Siebeck, Tübingen, 2004, chapter 16: 'Die Politik der Wettbewerbsordnung – die konstituierenden Prinzipien', 254n. See also W. Röpke, *Civitas Humana: Grundfragen der Gesellschafts- und Wirtschaftsreform* (Eugen Rentsch Verlag, Zurich, 1944), 262n. and 274n.

ern European banks had already lost one-fifth of their equity capital and are likely to lose another 30 per cent. In total, the IMF forecasts imply that 81 per cent of the 2007 equity capital of the US banking system and 50 per cent of the equity capital of the Western European banking system will have been wiped out by the end of 2010 through write-offs on toxic assets, not counting the subsequent public and private efforts to inject new equity.

Given that the regulatory system requires certain minimum equity levels in proportion to the business volume, the banks must react by scaling down their business and reducing their lending to firms. This problem cannot be solved by simply providing more liquidity. The central banks can pump as much money into the economy as they wish and even reduce their lending rates to zero, but they will still be unable to get credit flowing again.

Providing cheap central bank money while equity losses and bankruptcies limit the credit volume mitigates the solvency crisis only insofar as it drives up the banks' profit margins and generates exceptionally high rates of return on equity, out of which new equity can be formed. The reduced credit supply keeps the banks' lending rates up despite the fall in credit demand, and at the same time central banks allow banks to borrow as much as they wish at extremely low interest rates, in the eurozone at 1 per cent and in the USA even at 0 per cent during the crisis. Small wonder that investment banks like Goldman Sachs, Morgan Stanley, and Deutsche Bank were again reporting high profits in 2009. The high margins allow banks to gain weight, provided that they do not spend their windfall profits on dividends and bonus payments to their managers, and gradually recover, re-establishing their lending capacity.

This solution to the crisis is unsatisfactory as it takes an unnecessarily long time and slows down the recovery process of the real economy, carrying the risk of becoming infected by the Japanese disease. Moreover, it basically implies that firms and taxpayers are to re-establish the equity base of the banking system without getting anything in return. Firms, already stressed by the crisis of the real economy, pay higher interest rates, and taxpayers must bear the burden resulting from the reduced flow of interest earnings that the central bank normally transfers to the government budget. In the presence of a shortage of private bank equity capital, a low-interest policy of central banks is little more than directly bailing out the banks with taxpayer money.

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**BAD BANKS AND BAD IDEAS**

Bad banks are hardly a better means to hand public gifts to the banking system. It is true that the Geithner Plan (PPIP) used in the USA has the potential of re-establishing the equity base faster than mere interest rate policy would, in particular since it has a gigantic potential volume of up to \$1 trillion. The plan contemplates the establishment of private-public limited liability partnerships that are highly leveraged with public or publicly guaranteed loans and that will probably cause substantial losses for the government. The government losses mirror the likely private gains that the participating hedge funds and the banks selling the toxic assets will share. However, only some of the government's gifts end up as equity capital in the banks' balance sheets, and again, of course, taxpayers do not get anything in exchange for their good deeds.

Despite its advantages for the private sector, the plan currently does not really seem to be working, as it would require banks to recognize the write-offs on their toxic assets that they thus far have successfully kept concealed. The necessary scaling down of other operations to satisfy the regulatory equity requirements after the recognition of the write-offs scares many banks off and induces them to wait until the very last minute before they recognize such write-offs.

The German bad bank system suffers from the same problem, as many banks find it unbearable to recognize the required 10 per cent write-offs on the book values of assets to be sold to the bad bank. Unlike the American system, the German system does not involve gifts to banks, as all losses of a bad bank have to be covered with imputed interest from the dividends of the original bank. However, there are potential accounting advantages. For one, the toxic assets can be exchanged for government-guaranteed bonds issued by the bad banks that need no backing by regulatory equity capital. For another, the liability from being obliged to service the losses of the bad bank does not have to be shown on the balance sheet. Thus a surplus of regulatory equity capital is provided that banks can use to expand the credit flow to private business. However, in effect, this whole construct is nothing but a trick that helps private banks to undercut the regulatory minimum equity constraints of the Basel system, equivalent to measures that would cut the minimum equity requirements (see below). It will result in an even weaker banking system.

During its banking crisis of 1991 and 1992, Sweden showed what a successful strategy would be like and under what conditions a bad bank can be

set up. Sweden's crisis started after the real-estate bubble of the 1980s had burst, the rate of inflation had risen sharply, and the exchange rate of the Swedish krona had come under pressure. The Swedish crisis was much more severe than the current crisis for the banks of the Western world, as its depreciation losses amounted to 12 per cent of gross domestic product at the time.<sup>4</sup> Today this value is only exceeded by Bermuda and Switzerland.

The Swedish government offered the troubled banks a partnership and a takeover of the toxic securities by government-financed bad banks. Two Swedish banks, Nordbanken and Götabanken, took advantage of this offer in 1991 and 1993, respectively. They had to accept the government as a co-owner, and only then were the toxic assets placed in bad banks. The government spent a total of 65 billion kronor for recapitalizing the banks, corresponding to 4 per cent of Sweden's gross domestic product.

Having the government take over the banks did not mean that the banks lost their private legal status, but that the government became the dominant owner and then determined the business policy. The other banks procured additional capital in the market and had to write off their problem securities without being able to sell them to a government bad bank. Nordbanken and Götabanken were merged in 1993 and later, together with other northern European banks, merged into Nordea Bank. In the meantime the government has sold the majority of its shares and now holds only 19.9 per cent of the equity in the bank. Today Sweden again has a functioning private banking system. The crisis is long forgotten.

#### THE BANK HOSPITAL

Sweden basically hospitalized its troubled banks, performed surgery on them, and then released the recovered patients back to normal life. The Swedish experience could become a guideline for other countries, as it is neither acceptable that the governments and the central banks distribute gifts nor that the banks reduce their credit supply despite cheap central bank money and recapitalize their balance sheets via high interest margins. A bank hospitalization plan based on a potential co-ownership in a rescue fund could look like this: a minimum equity – asset ratio of 4 per cent and

<sup>4</sup> European Economic Advisory Group at CESifo, *EEAG Report on the European Economy 2009* (CESifo, Munich, 2009), 95.

a minimum Tier 1 ratio of 8 per cent (instead of the present 4 per cent in the Basel system) is introduced, subject to smoothing provisions to prevent scaling down the balance sheet as will be detailed below. If the bank cannot find enough private capital to satisfy this requirement, it must accept the fund stepping in with the missing capital and so becoming a temporary shareholder. When the crisis is over and the banks have recovered their health, they can leave the hospital. The fund sells its shares and the banks again stand on their own feet.

The fund should be financed by contributions of the banking system and have enough capital to help the banks in case of crisis. If a crisis occurs before a sufficient amount of equity capital has been accumulated, the government must step in. It can lend the necessary capital to the fund at market conditions, and the fund would then have to repay the capital later.

The increase of the minimum equity requirements would help establish a better banking system with a larger equity buffer that enhances stability in case of a crisis, and it would foster a more prudent approach in the choice of business models, as shareholders will encounter higher potential losses if they demand risky investment strategies from their managers. Of course, there is a transition problem by requiring more equity even as the crisis has wiped out a substantial fraction of it. If banks cannot raise the necessary equity in the market, this problem has to be solved with equity provided by the rescue fund. The co-ownership of the fund would provide a quick way to solve an imminent crisis by re-establishing the lending capacity of the banking system, despite the necessity of increasing equity requirements. Unlike the low-interest policy of central banks or the Geithner Plan, the rescue fund would inject more equity into the banks without making gifts, because it would receive new shares in exchange for the capital it provides. The bank hospital rescues the banks, but not the banks' shareholders.

Some people may have misgivings about the possibility of the government being involved. But they ought to consider the severity of the crisis into which the banking system has slid, dragging down the world economy in the process. Before complaining of 'socialism' and becoming the victim of mere semantics, one should acknowledge that often there will only be two alternatives for the government: to provide repayable credit to the fund to save the banks, or to help nonetheless and get nothing in exchange. Equally impossible is to just ignore the huge write-offs that have already been performed and that will have wiped out more than half of the equity capital of the Western world's banking systems by 2010.

The fund's shareholding, after all, is not an expropriation, but a forced equity increase. There is little arguing against but a lot of arguing in favour of the private shareholders remaining on board. The bank must sell as many new shares to the fund at the going market price as are needed to achieve the required equity ratios. Private shareholders should not have the right to block this if they disagree with the terms. What their shares are worth is determined by the stock market, not the balance sheet.

Let us take the example of a bank that has \$30 billion in its balance sheet but is valued at only \$15 billion on the stock market. That is not an unrealistic case, as the stock market prices the expected future write-offs even before their booking is required by the accounting rules. Assuming that the bank needs a total of \$60 billion to meet the minimum capital ratio, given the previous size of its balance sheet, the rescue fund would have to provide \$30 billion for an equity increase. If it must pay the market price for the shares it receives in exchange for the capital provided, it will subsequently own two-thirds of the bank.

The fund now has the controlling interest, and that also has a market price. There are common procedures, applied by external consultants, for the determination of the necessary mark-up on the stock market price. The fund can present its offer on the basis of relevant expert analyses.

To ensure that the private shareholders are not cheated in this transaction, the bank should be allowed to offer the new shares at the agreed terms first on the stock market. If it gets a higher price than that offered by the rescue fund, it can sell its shares there. If not, it is the fund's turn to buy them.

The banks must not become a government agency. The government has money, but is a bad banker. It is imperative, therefore, that the private legal status be retained. It protects the minority shareholders and the economy from the government abusing its position of power. If it should use its power to force the bank into transactions that are supposedly in the common interest but reduce the bank's value, the minority shareholders have a right to compensation that they can enforce by legal action, if need be. The private legal status is also necessary because the rescue fund must sell its shares as soon as the crisis ends, at a profit if possible. The stay in the bank hospital should be as short as possible.

#### TOO BIG TO FAIL, TOO SMALL FOR PRUDENCE TO PREVAIL

To prevent future banking crises, some economists, notably Mervyn King, the Governor of the Bank of England, advocate the old Chicago way

of inducing prudence by threatening to let banks go under if they violate the minimum equity constraints.<sup>5</sup> These economists, of course, see the risk of another collapse of the financial system if the government does not rescue systemically relevant banks. However, they argue that one should dismember the big banks to create sufficiently small units that need not be rescued if they default. If banks are too big to fail, make them small enough so that they can fail without causing further problems!

While this idea does have intuitive appeal, at closer scrutiny it raises serious doubts. A world with small banks may not function well, and the government may have to rescue the small banks nevertheless in case of a systemic crisis.

The obvious argument against a system with many small banks is that it would destroy the network economies from which banks and the economy have benefited so much. Banks usually have huge networks of branch offices and subsidiaries, often even international ones, for their transactions. Cutting these networks into pieces will probably increase the transaction costs of the market economy and impede economic exchange, which is the basis of gains from specialization.

And, of course, dismembering the banks would not imply that the government could twiddle its thumbs in an epidemic like the current one. When many small banks fail simultaneously because of systemic or correlated investment risks, all of them will have to be rescued nonetheless. Smallness would make it possible to dispense with government help only if investment risks are uncorrelated, but this can hardly be turned into an argument for smallness, as big banks would not be destroyed by uncorrelated investment risks in the first place. The whole question of government help arises only in the case of correlated or systemic risks, and in this case small and big banks alike would have to be rescued.

And with uncorrelated investment risks smallness may even cause additional problems insofar as it increases the incentive to gamble, due to gambling with limited liability. This incentive would not result in a sudden systemic crisis, but could nevertheless create a chronically deficient economy that suffers from excessive risk-taking with high private but low social rates of return.

To clarify this point, let us compare a big bank with a number of small banks of the same aggregate size and assume the big bank consists of

<sup>5</sup> Address of Mervyn King to Scottish business organizations, Edinburgh, 20 October 2009, online at [www.bankofengland.co.uk](http://www.bankofengland.co.uk), accessed on 16 November 2009.

branches that resemble the small banks and finance the same type of investment projects. If the investment projects are safe, there is no difference between the big bank and the aggregate of small banks. But with risky investment projects whose maximum possible loss exceeds the liable equity capital, things are different. If risks are uncorrelated, losses normally do not occur simultaneously. Thus a big bank will in most cases simply subtract a loss occurring in a particular branch from another branch's profit. Only very rarely will the losses occur simultaneously, forcing the creditors to foot the bill. Things are different when the branches operate as separate small banks, because then they cannot net out losses and profits. Other things being equal, a small bank has a larger default probability and will therefore also have a higher probability of offloading its losses on its creditors, which implies a higher expected or average bank profit. Thus the incentive to gamble is larger for the small banks than for the big bank.<sup>6</sup> Midgets gamble more eagerly than giants.

This is the reason why George Soros prefers to have many small legally separate hedge funds endowed with limited liability rather than a big one consolidating all the risks undertaken. Each hedge fund is a gamble in a stochastic environment. If the gamble is successful, the profit belongs to George Soros. If it fails, the excess of the loss over equity falls on the creditors. As at least some of the risks are stochastically independent, Soros is able to make more profit by keeping his hedge funds separate instead of combining them into one big conglomerate.

Gambling with limited liability implies diseconomies of scale, whereas the network effects mentioned above imply economies of scale. Policy-mak-

<sup>6</sup> For the mathematically interested reader some statistical considerations may be helpful. Suppose the big bank consists of  $n$  similar branches with stochastically independent investment projects with identical probability distributions of end-of-period wealth (before limiting liability by imposing a lower wealth constraint at zero). The big bank is compared to  $n$  small banks, each of which acts as one of these branches. The end-of-period wealth distribution of the big bank has an expected value and a variance, each of which is  $n$  times the respective value of the small bank. This implies that the standard deviation of the big bank's end-of-period wealth is  $\sqrt{n}$  times that of the small bank and that the coefficient of variation (the ratio of the standard deviation to the mean) for the big bank is  $1/\sqrt{n}$  times that of the small bank. It follows from Chebycheff's inequality that, regardless of the shape of the probability distribution, the upper bound on the probability of default (wealth becoming negative) diminishes when  $n$  increases, approaching zero as  $n$  goes to infinity. For non-pathological probability distributions (including the normal one to which the big bank's distribution converges) the default probability itself (and not only its upper limit) diminishes throughout when  $n$  increases.

ers should not worry if the net effect of these diverging forces gives rise to big banks, because the economies of scale reflect social and private advantages, while the diseconomies of scale are only private, resulting from the reduction of a negative externality. Big banks are too big to fail, but small banks may be too small for prudence to prevail.

#### BUILDING A COMMON SUPERVISORY SYSTEM

Rescuing the banks from their acute crisis does not necessarily require international harmonization. Every country is sufficiently interested in maintaining its banking system and implementing the necessary support measures. It suffices to create provisions that prohibit a government from excluding foreign banks from operating within its borders or foreign partners of domestic banks from the rescue measures.

It is important, however, to institute international harmonization of the long-term regulatory rules of the banking system in order to put paid to the competition in laxity that has crept in over the past decades. Toward this end, the governments of the world should agree on a Basel III framework that determines the details of banking regulation in terms of minimum standards for the quality of bank products. At the G-20 summits held during the crisis, initial efforts were made for such a harmonization of banking regulation.

In this endeavour, international institutions with corresponding competencies must be created. Entrusting the IMF, the UN, or the Bank for International Settlements (BIS) with the responsibilities of a super-ordinate regulatory body suggests itself. This cannot mean, of course, that this body should supervise the banks individually, but rather that it would stand at the apex of a hierarchy of supervisory agencies and give directives, if need be, that must be followed by the subordinate institutions.

The next level down could be occupied by the central banks or independent supervisory agencies designed in accordance with a uniform organizational plan. In Europe it is necessary in any case to create a common European agency, above the level of national regulatory bodies, endowed with the right to issue directives to the national agencies.

To be sure, in many areas the subsidiarity principle, anchored in the Maastricht Treaty, argues in favour of solutions at the national level. But such solutions are out of the question with respect to banking regulation, due to the destructive force of the competition in laxity.

The European Central Bank, with its subordinated national central banks and its political independence, offers a possible framework for the organization of supervision,<sup>7</sup> but it is not imperative that it assume this role. A new EU-wide supervisory agency could well enough be established, if desired.

It is obvious that national supervision in the individual European countries has outlived its purpose, given that hardly any of the big European banks restricts its activities to its home country. Almost all big banks are internationally active corporate groups today, so that national borders have lost significance. It is thoroughly impossible to have such corporations regulated in a meaningful way by national supervisors. But, of course, the content of regulation is even more important than the organizational structure of the supervisory bodies.

#### BASEL III AND THE ACCOUNTING RULES

The crisis was caused by weaknesses of the US regulatory system and aggravated by deficiencies of the Basel I system used in Europe and many other countries. The new Basel II system, which became operative in 2008, did not do much better. The world now needs a Basel III system with much tougher regulatory constraints that reflect the lessons so painfully learnt during the crisis.

The new Basel system must be uniformly applied throughout the world, at least by the G-20 countries. The USA, in particular, would have to join in. Despite being one of the initiators of the Basel system, the country in the end did not subscribe to the system. This may have been one of the reasons why the US investment banks, freed from any equity regulation by the 2004 SEC decisions, turned into gambling casinos.

An important prerequisite for a worldwide application of a new Basel system is the harmonization of accounting rules. Currently there is a confusing variety of such rules. In Europe, for example, there are many national accounting systems that are only gradually being replaced by the common *IFRS* system endorsed by the EU Commission. The *IFRS* system is being defined and controlled by a London-based accounting institution, the *IASB*, which itself is a member of an organization based in Delaware,

<sup>7</sup> European Economic Advisory Group at CESifo, *EEAG Report on the European Economy 2003* (CESifo, Munich, 2003), chapter 4, 98n.

USA.<sup>8</sup> The USA, however, does not use the Delaware system, but the *US GAAP* as formulated and controlled by another accounting institution, the *FASB*.<sup>9</sup> US GAAP is not written in law, but it is binding insofar as the US supervisory authority SEC requires that it be followed in financial reporting by publicly traded companies. IFRS and US GAAP have the same origins and are largely based on the same basic principles, including the problematic mark-to-market principle. However, the IFRS has moved away from US GAAP in many respects, giving rise to substantial confusion. For example, US GAAP allows banks to net out certain assets and liabilities, a practice that shortens the balance sheet relative to what the European accounting system would permit. How large the practical implications of this provision are was demonstrated by Deutsche Bank. It showed that its balance sheet would be cut in half if it switched from IFRS to US GAAP. In view of these differences, one of the most important tasks of the G-20 meeting is to agree on a procedure to establish a common worldwide accounting system.<sup>10</sup>

Other contents of a better regulatory system have already been discussed extensively elsewhere in this book. By far the most important rule consists of requiring substantially higher equity capital than today is the case. That is the key strategy for the recovery of the banking system. A high equity ratio provides a better buffer against shocks and, above all, encourages more prudence in dealing with risk because it increases the shareholders' liability.

The higher equity requirement also enjoys backing in Europe. For example, the Larosière Commission, established by the EU in February 2009, has argued emphatically for an increase in the minimum equity ratios as compared to Basel II.<sup>11</sup> On the other side of the Atlantic, however,

<sup>8</sup> IASB stands for International Accounting Standards Board. It is an institution of the International Accounting Standards Committee Foundation (IASCF) that was founded in 2001 and is located in Delaware.

<sup>9</sup> US GAAP stands for United States Generally Accepted Accounting Principles, and FASB for Financial Accounting Standards Board. FASB is the highest US authority for the establishment of generally accepted accounting principles for public and private companies as well as non-profit entities. In 2008, the FASB issued the FASB Accounting Standards Codification that reorganized the thousands of US GAAP pronouncements into roughly 90 accounting topics.

<sup>10</sup> Some attempts in this direction have already been made. For example, in the *Norwalk Agreement* of 2002 FASB and IASB declared their commitment to a convergence of the accounting standards. However, in practice, little has happened.

<sup>11</sup> *The High-Level Group on Financial Supervision in the EU*, chaired by Jacques de Larosière, Report, Brussels, 25 February 2009, text to figure 59 and *passim*.

tougher equity rules do not seem to meet with undivided agreement. Thus, in the final protocol of the G-20 Summit in London in April 2009, this point was only mentioned briefly in connection with a limitation of leverage.<sup>12</sup>

Stating precise demands on the basis of general insights is, of course, not free from personal judgement. The figures mentioned above, 4 per cent for the equity asset ratio and 8 per cent for the Tier 1 ratio, could however serve as the basis for discussing a Basel III agreement. These ratios should not only apply during the crisis with the help of government equity, but also over the long term as minimum ratios to be adhered to by the banks of all countries. The difference from short-term crisis management is only that the ratios have to be achieved with private capital alone in the long term, as the government has to sell its shares once the crisis has been overcome.

While the two minimum equity ratios proposed should be adhered to quarter by quarter, it is important that an element of intertemporal smoothing be introduced to prevent banks from scaling down their operations during a crisis. An easy way to achieve this is to require that in each quarter the equity and Tier 1 capital available at the time satisfy the two ratios also with regard to a rolling average of the respective balance sheet items over the last three years. As banks know that they will not be able to accommodate equity losses with reduced lending, they will probably react to this provision by holding excess capital above the required minimum in order to minimize the risk of having to allow the government to step in, which is a useful reaction.

Basel III should also revise the system of risk weights used to calculate the sum of the risk positions. As explained, the Tier 1 ratio is at present calculated by dividing the capital, consisting of nominal capital, reserves, and dormant investment, by the sum of the risk positions. As the sum of the risk positions accounts for only a fraction of total assets, the Tier 1 ratio suggests a capital ratio that is sometimes up to five times the actual equity – asset ratio. This confusing practice must stop. Basel III needs a fairer valuation of risk-weighted assets, on whose basis the sum of risk positions averaged over all banks can be brought much closer to the value of bank assets.

The system of risk weights should also be simplified. The sophistication of the Basel system was meant to bring about more clarity, but in fact it turned out to be one of the causes for the opaqueness of the banking system.

<sup>12</sup> See 'Leaders' Statement. The Global Plan for Recovery and Reform', paragraph 15, 2 April 2009, online at [www.g20.org](http://www.g20.org), accessed on 13 April 2009.

It is impossible to really assess the soundness of a bank by looking at the Tier 1 ratio because the exact meaning of the sum of risk positions remains obscure as a result of the complexity of the calculations. Only insiders understand the system of risk weights, and all too often they cannot resist the temptation of using their superior knowledge to hide the inferior quality of some of their risky investments. This opaqueness also gives rating agencies a weightier role in the risk assessment process than they are able to play and creates huge moral hazard problems on their part. If bank-issued securities are lemon products it is because the sophistication of the system of risk weights has largely contributed to the opaqueness of financial products.

The new Basel system should prescribe much higher risk weights for investment in securities relative to company loans. In the current Basel system, for example, banks have to back loans they make to sound medium-sized firms of the real economy with substantially more equity than investments in mortgage-based US securities of the MBS or CDO type, whose market has meanwhile collapsed completely. This practice must be terminated. Loans made to individual borrowers who can be taken to court if they do not pay should generally be considered safer than anonymous securities that do not imply a title against the issuing institution but only against the collateral it provides. The risk weights must generally be increased and readjusted so as to recognize the high risks of structured financial products relative to claims against individuals or firms that are directly liable.

Theoretically, there could be bottlenecks in the short run when more equity is suddenly required, as the banks would first have to generate the needed equity. But, as explained, this problem will be solved by the government's equity injection according to the bank hospitalization plan. In the long term an economy may be organized with largely arbitrary capital ratios of banks, as the savings of the economy always suffice to finance the investment. In principle, it does not matter whether the savings flow to the firms as equity or debt. If higher capital ratios are demanded, a higher share of savings will be changed into bank equity via the purchase of newly issued bank shares or as retained bank profits while the proportion of savings that the banks receive as deposits or by the sale of bank bonds declines.

The representatives of the banks will not like these proposals, given that they imply capping the return on equity as a result of creditors and taxpayers not being as highly burdened if disaster strikes. The business model of the banks, which consists of generating returns out of mere risk because the negative parts of the profit distribution are mostly pushed onto others, will lose its foundation. However, if a lesson may be learnt from this global crisis, it is that this business model must indeed be prohibited.

## CREDIBLE REGULATION

A simple capital regulation prescribing the banks the equity ratios they must adhere to in good times will not knock down unsound business models, however. It is decisive for the success of regulation to determine what the government will do if the regulatory limits are breached. Without defining the penalties for a rule violation, the best regulatory law will be fairly toothless.

Therefore, it is important for the banks to be fully aware of the government's plans for the event of crisis. In today's crisis, the governments' actual actions lay the foundation for determining the expectations of future government conduct. Two extreme cases of detrimental banks' expectations regarding government conduct spring to mind.

The first consists of the expectation that the government or the central banks will directly or indirectly bail out the banks with equity gifts such as appropriately constructed bad bank models, toxic asset purchase programmes, or low central bank interest rates. This case obviously means that the banks' equity will not be lost when things go wrong after excessive risk-taking, because the government or the central bank will act as lenders of last resort. It would be the same as if a thief caught *in flagrante* were paid compensation for surrendering the stolen goods. No wonder then if burglaries should increase.

Gambling is even promoted in this case, because the liability of the owners is limited not to their entire capital but only to the capital that exceeds the regulatory minimum level. The part of the equity that is required by regulation is protected from any risk because the government or the central bank tops up the equity should it fall short of the required minimum. The shareowners' participation in the bank's profits and losses would then be even more asymmetric than in the case of limited liability alone, and an even greater portion of the losses would be socialized. As a result, in economically normal times the banks would take risks even more irresponsibly, thereby raising the probability of another crisis. This is the major reason for rejecting outright gifts to the banks like those implied by the Geithner Plan, and it even raises doubts about a central bank policy that simply reduces its interest rates while the supply of credit is constrained by insufficient bank equity.

The second case of detrimental expectations consists of the banks assuming that the prevailing regulatory law will be applied mercilessly: neither the government nor the central bank will help the banks but will, long

before legal insolvency, cancel their banking licence if capital falls below the regulatory limit.

This case is not probable, as those banks that consider themselves systemically relevant do not believe in the effectiveness of this regulation. But let us assume for the moment that they do believe in it. The banks would still incur big risks whose possible losses could exceed the bank's equity capital, but in their normal business activity they would try to keep a good distance from the prescribed minimum capital ratios in order to avoid disclosure at smaller losses. They would reduce their loans and investments at the slightest sign of a potential crisis in order to avoid the risk of insufficient coverage. But this would depress the market value of the assets and would cause trouble for other banks and non-financial firms, thereby triggering and then aggravating the crisis. Rigid capital regulation, which is intended to protect from a crisis, can accelerate the pace of the crisis if the government adheres strictly to the regulatory prescriptions and does not step in to help.

Both types of expectations are evidently detrimental. One leads to carelessness and increases the probability of a crisis. The other creates and aggravates the crisis once initial doubts spread. The solution to this dilemma is the bank hospitalization strategy described above that rescues the bank without rescuing the bank's owners. The rescue fund helps out when actual equity falls below the regulatory minimum and private capital cannot be found, but it requires shares of stock for whatever equity it provides. This strategy gives immediate relief in case of a crisis, avoiding a credit crunch, while at the same time setting the right incentives for more prudent bank behaviour in the future, reducing the incentives for excessive risk-taking, provided of course that regulations require sufficiently large capital ratios.<sup>13</sup>

Admittedly, banks will still have an incentive to scale down their operations if equity losses occur, to avoid the fund stepping in as a co-owner. However, they surely will be less afraid of the fund's help than of a loss of their banking licences and will therefore not resort to brutal deleveraging strategies. Moreover, the smoothing rule, according to which the minimum equity requirement is defined in relation to the average balance sheet items of the last three years, limits the possibilities for deleveraging strategies.

Another way of reducing the risk of deleveraging and the gambling incentives provided by government gifts is to temporarily soften the regula-

<sup>13</sup> Cf. M. Hellwig, foreword to H.-W. Sinn, *Risk Taking, Limited Liability, and the Banking Crisis* (Selected Reprints, Ifo Institute, Munich, 2009).

tory equity requirements in a crisis. This was argued by a group of German economic advisers,<sup>14</sup> and it is the road the EU followed with its decision of autumn 2008 to permit the banks to move toxic assets retroactively from the trading book to the banking book of accounts.<sup>15</sup>

Indeed, softening the regulatory requirements also offers a way to subject a larger part of the capital stock to legal liability and to keep the banks operating despite the failure to meet the original regulatory capital limits. It thus avoids an aggravation of the crisis caused by the regulation paradox and does not provide any additional incentives to gamble beyond those already implied by the general limitation of liability to equity.

However, this strategy is incapable of increasing the capital base of the banks in a crisis and makes no contribution to strengthening the solidity of the banking system. It is, therefore, unable to restore the mutual confidence in interbank transactions and may actually contribute to the destruction of trust. Turning off a fire alarm during a fire may temporarily prevent panic, but it will reduce the efforts to fight the fire and could, in the end, fuel an even greater panic.

In addition, after the crisis it will be difficult to effect the political transition from a regulation that has become laxer, if only temporarily, to one that is stricter than before the crisis. How can one ever move from even lower regulatory equity requirements than those that allowed the storm of the crisis, to stricter requirements once the weather has cleared and the sun is shining again? Since memories are short and politicians are only elected for short terms of office, the banks' lobbies will be able to make sure that the business model that generates profits out of leverage, limited liability, and risk will not be touched. For political reasons, reforms of the banking system for the long term can best be implemented in the midst of the crisis. Politicians should take care not to let a serious crisis go to waste.

A credible hospitalization strategy for the case of insufficient equity consists of announcing the rescue fund's acquisition of an equity share in troubled banks and in demonstrating such a policy by the actions taken during the crisis. Capital regulation that threatens a penalty in the form of

<sup>14</sup> Scientific Advisory Council to the German Ministry of Economics, *Zur Bankenregulierung in der Finanzkrise*, letter to Minister Michael Glos of 23 January 2009, online at [www.bmwi.de/BMWi](http://www.bmwi.de/BMWi).

<sup>15</sup> European Commission, Amendment to IAS 39 and IFRS 7 'Reclassification of Financial Assets', online at [www.ec.europa.eu/internal\\_market/accounting](http://www.ec.europa.eu/internal_market/accounting).

withdrawal of the banking licence is useless if the penalty is not imposed in case of crisis, on the grounds that no system-relevant bank can be allowed to collapse. And regulation that promises gifts in case of crisis fosters carelessness. But a regulation that announces and practises the bank hospitalization plan laid out above is credible, effective, and reasonable.

#### EXECUTIVE PAY

The prevailing public impression seems to be that the misconduct of the banks can be primarily ascribed to their managerial compensation systems. This criticism focuses on excessive bonuses that hinge on short-term success, inducing managers to gamble and neglect the long-term success of their bank. The greed of the manager caste is being thoroughly pilloried. All of this is understandable, as the managers stand in the limelight as puppets of the shareholders and are well suited to personifying the object of blame sought by the media and serve as scapegoats.

Indeed, the bank manager compensation systems are designed in such a way that they leave grounds for criticism: if managers are successful, they receive a juicy bonus, but in the event of failure there is no malus, or penalty. This asymmetry induces them to gamble. No wonder that even the G-20 countries are currently paying a lot of attention to manager compensation.<sup>16</sup>

However managerial compensation systems are not originally responsible for the misconduct, as they are derived from the shareholders' incentive systems. It is the shareholders who profit from the limited liability of the institution and push for risky business models with low capital input, in order to derive private profits from mere risk. Their own compensation system also knows only the bonus, but not the malus. In any case, the malus is limited to the little bit of capital that they inject into the banking business. The same asymmetry is reflected in the managerial compensation system. The shareholders are the principals, the managers only their agents. The shareholders look for managers who are able to juggle the risks of modern banking, and via the supervisory board they design the bonus systems in such a way that the managers fervently intensify their efforts in this respect. No management can survive its frequent 'road

<sup>16</sup> See 'Leaders' Statement: The Global Plan for Recovery and Reform', paragraph 15, 2 April 2009, online at [www.g20.org](http://www.g20.org), accessed on 13 April 2009.

shows' in the face of the advice analysts give to shareholders, unless managers present a convincing business model that promises a sufficiently high rate of return on equity.

It is therefore fairly futile for the government to try to influence the design of the contracts between shareholders and managers in order to prompt the managers to pursue a sustainable, long-term business policy. The government will not succeed if it does not change the shareholders' compensation system. Only by forcing shareholders to provide more capital for the banking business and thus also to accept true penalties when business turns sour, will they design better incentive systems for their managers. Besides, the compensation systems are much too complex and multifaceted for governments to even try to redesign them. The ideas to fine-tune policies to such an extent are absurd. No, the key to all of this is strict capital regulation with the goal of weaning shareholders from their gambling addiction, an addiction that is the result of evolutionary learning and imitation in good weather periods rather than a conscious or even conspiratorial optimization behind closed doors. If stricter capital regulation is introduced, market behaviour will gradually change and bring about more cautious and prudent business models implemented through appropriately incentivized bonus systems.

There is no disputing the fact that, from a legal point of view, reforms are needed to reformulate the responsibilities and the control function of banks' supervisory boards. Executives may have too much scope for procuring advantages from the shareholder representatives in an uncontrolled way. But this is a completely different issue that has little to do with the crisis and the stabilization of the banking system. An improvement of manager control by shareholder representatives cannot limit gambling in any way and therefore cannot contribute to stabilizing the banking system. The opposite could well be the case. Despite all the public excitement over the managerial echelons, some executives do succeed in protecting the banks' capital from being looted by the shareholders. They may do more for the sustained development of the bank than is to the liking of shareholders, who prefer returns on capital of 25 per cent or more. To increase the power of banks' shareholders is certainly not the right strategy to induce executives to aim for greater sustainability.

The government has many responsibilities in the market economy. Intervening in the compensation systems of private businesses is surely not one of them. Prices and wages can only fulfil their control function if they are determined by market forces. They are signals of scarcity that optimal-

ly assign people and capital to alternative uses in an economy characterized by the division of labour. As important as it is to keep externalities under control by means of extensive regulation, it is wrong to try to change prices and wages through government intervention. It may not even be useful for reasons of social justice, as distribution goals can be better achieved by the state's tax-and-transfer system. This is the basic tenet of economics that cannot be emphasized enough, even though this is not the place to present the economic foundations of this insight.

#### ELIMINATING THE PROCYCLICALITY OF THE SUPERVISORY SYSTEM

More important than manager compensation are the accounting rules prescribed by the government, as they are partly to blame for the crisis. The mark-to-market method, which is specified by the globally valid IFRS accounting system, has intensified the crisis. It first overheated the bubble because it inflated book profits over and above the real value of the business, and then it exacerbated the downswing, as it forced the banks to write down assets and to scale down their business so as to satisfy the supervisory minimum equity constraints.

An option to overcome this deficiency could be to introduce Colbert's lowest-value principle. Creditor protection calls always for the most cautious valuation method to be chosen, instead of continuously adjusting the valuation of the assets to changing market prices. Accordingly, after comparing the market value and the acquisition cost, the lower of the two ought to be used. For long-lived assets it will normally be the acquisition cost, with the result that hidden reserves accumulate in the balance sheets.

The hidden reserves may serve as capital buffers in times of crisis to meet losses without having to change the balance sheet positions. The procyclicality of the mark-to-market method would be avoided in this way. By following this proposal, the world would repeat the step taken by Germany after the bitter experience of the Big Panic (*Gründerkrise*) of 1873, with the reform of its commercial law in 1884 that reintroduced the lowest-value principle.

Alternatively, or additionally, the supervisory capital ratios could be changed procyclically. During a boom, when asset values increase and highly leveraged equity shoots up, the Tier 1 ratio could be increased, so as to force the banks to build up an equity buffer; in recessions it could be reduced so as to prevent the banks from adjusting their lending procyclically. Spain has already implemented such a system, with good success. The

Larosière Commission also advocates it for a reformed Basel system.<sup>17</sup> An appropriate macro-prudential supervision framework for the respective central bank system could provide the guidelines for supervisory bodies to adjust the ratios.

#### TAMING THE SPECIAL PURPOSE VEHICLES AND HEDGE FUNDS

One can learn from Spain and Italy regarding another issue as well. As is well known, many European banks exploited a regulatory gap in the supervisory systems by running big risks outside their balance sheets via businesses carried out in special purpose vehicles and conduits residing in tax havens such as Ireland or Bermuda. Using their foreign shadow subsidiaries, they spun the big wheel of fortune without having to provide capital, as the transactions of the shadow banks were not carried on the domestic balance sheets and the countries hosting the shadow banks did not supervise such activities properly.

Regarding this issue, the Spanish and Italian supervisory agencies were smarter. They successfully banned shadow banking activities by forcing banks to carry all offshore transactions on their balance sheets, which automatically implied capital backing in accordance with Basel II.

The Spanish-Italian rule ought to be adopted by the new Basel III system. This would provide a buffer to cushion potential losses of the special purpose vehicles and, above all, would pull the rug from under this business model. Although this will be hard on Ireland and other countries as one of the motives for locating special purpose vehicles there would disappear, it is indispensable for the stability of the Western world's banking system.

Similar is the situation of hedge funds, the Anglo-Saxon counterparts to the special purpose entities more common in continental Europe. They undertake extremely risky transactions with huge leverage and minimum capital input, as they are not subject to any supervision. Their business no longer has much to do with hedging capital markets, and much with gambling *par excellence* resulting from limited liability. As hedge funds are dying like flies during the current crisis, they can hardly be seen as exerting a stabilization function.

<sup>17</sup> *The High-Level Group on Financial Supervision in the EU*, chaired by Jacques de Larosière, item 60.

Should banks continue to be allowed to own hedge funds, such hedge funds must be fully carried on the balance sheets and subjected to Basel III regulation like the rest of the bank business, including special purpose companies. Those hedge funds not owned by banks should be regulated like independent entities and forced to back their transactions with capital. It is surprising that the Larosière Report is somewhat reluctant in this respect and that at the G-20 Summit it was only agreed to regulate the 'systemically relevant' hedge funds, whatever they may be.<sup>18</sup>

#### REINSTATING THE GLASS-STEAGALL ACT?

Initiated by former central bank president Paul Volcker, in autumn 2009, a new discussion began in the USA about reinstating a separation between commercial and investment banks. No less than President Obama suggested such a separation in a speech in January 2010.<sup>19</sup> He proclaimed the goal of separating the investment business from the deposit business to protect the savers and the federal deposit insurance agency FDIC against the risk incurred in the investment business. In particular, the President wanted to forbid commercial banks from participating in proprietary trade of financial products and from owing hedge funds and private equity firms.

The separation of investment and commercial banks has a long-standing tradition in the USA, dating back to the Glass-Steagall Act passed on 16 June 1933, a short time after the world depression's nadir. Commercial banks were allowed to use their depositors' money to lend to households, companies, and other banks, but were barred from acquiring securities or playing any role in their trading. The purchase of shares of stock was as prohibited as the acquisition of securitized financial products of any kind. Even the acquisition of company bonds or private debentures was reduced to a negligible minimum.<sup>20</sup>

<sup>18</sup> See 'Leaders' Statement: The Global Plan for Recovery and Reform', paragraph 15.

<sup>19</sup> See the White House, *President Obama Calls for New Restrictions on Size and Scope of Financial Institutions to Rein in Excesses and Protect Taxpayers*, Office of the Press Secretary, 21 January 2010, online at [www.whitehouse.gov](http://www.whitehouse.gov), accessed on 26 January 2010.

<sup>20</sup> Commercial banks were allowed to hold investment securities (bonds, notes, or debentures) up to 10% of the stock of equity capital, which was close to nothing given that the stock of equity was small if not tiny relative to the balance sheet even at that time. See Banking Act of 1933 (Glass-Steagall Act), Pub. L. No. 73-66, esp. sections 16 and 21 and amendment of 1935. Cf. *The Provisions within the Sections of the Glass-Steagall Act*, online at [www.cftech.com/BrainBank/Specialreports/GlassSteagall](http://www.cftech.com/BrainBank/Specialreports/GlassSteagall), accessed 26 January 2010.

After the Glass-Steagall Act was repealed in 1999, some commercial banks gingerly tried their hand at investment banking. This has fed the suspicion that this may have been one of the causes for the financial crisis. This is implausible, however, because the separation of the banking system into commercial and investment banks was in fact largely intact when the crisis hit. On the contrary, this separation itself may have exacerbated the crisis.

The crisis was triggered in 2008 when Lehman Brothers, against all expectations, was not bailed out by the government. This shattered the banks' mutual trust and caused the interbank market to seize up. The savers' funds could not be channelled on to investors anymore, accumulating instead in the commercial banks. This, in turn, brought about a collapse in the real economy. Had such banking separation not prevailed in the USA, the economy would have been less susceptible to a collapse of the interbank market, since the commercial banks would have been able to channel at least part of the savings directly to firms via the purchase of stocks, bonds, or debentures.

This makes one wonder what motivated Obama and Volcker. The answer probably lies in the metamorphosis that the investment banks Goldman Sachs and Morgan Stanley, the only ones among the large investment banks to survive the crisis, had undergone to turn into normal commercial banks on 22 September 2008. Behind this transformation was the wish of both banks to gain access to cheap credit provided by the Fed and enjoy the protection afforded by the FDIC during the crisis. The government had actually intended to exclude investment banks from special help, but these banks outsmarted it by quickly changing their legal status. Now Obama wanted to settle the score.

This is understandable, but for those parts of the world that have a universal banking system it is dangerous. This includes Europe, where the activities of investment and commercial banks have always been practised under the same roof. If Obama succeeds in pushing through such a banking separation system in its original form on an international basis during the G-20 negotiations, it would amount to a dismantling of the European banking world, while the effects for the US banking system would be much more limited.

An across-the-board return to banking system separation in any case would not equate to crisis prevention. While it is correct that lowering the expectations of government help would spur investment banks to exercise greater caution in their business, the separation of banking functions would make the system more crisis-prone because it would give the interbank market an even more important role. Furthermore, there is room for

doubt that such a separation would actually lower the expectations of government help. In a crisis, the government would have no option but to bail out large investment banks even if they hold no savings from depositors, unless it wanted to risk a repetition of the Lehman Brothers debacle. Lehman Brothers, it is worth noting, was not a commercial bank, and it was unable to impose a risk on its depositors because it had none.

The banks' fondness for risk that led to the crisis stems from the overly lax equity requirements that made them gamble with limited liability. As the banks' owners risked little of their wealth, they felt tempted to engage in overly risky activities, knowing that they would be able to keep all the profits and shift the potential losses onto other shoulders, regardless of whether the government came to the rescue or not.

Gambling with limited liability can only be banished by drastically increasing the regulatory equity requirements, which would have the added advantage of keeping the banks from keeling over when the wind picks up a bit. Strengthening the banks' equity capital is by far the most important requirement of any meaningful financial reform.

Still, the proposal of erecting a firewall between the normal banking business and extremely risky speculative activities could be useful, making such activities more transparent and preventing the banks' creditors from being made liable without their knowledge for the potential losses involved. This firewall, however, should not separate the entire investment banking business, as the Glass-Steagall Act did and Obama proposed, but instead be placed farther out, fencing out only the most risky business areas. This way, it would indeed make sense to ban banks from owning private equity firms, hedge funds, or special purpose vehicles. Investors could then decide in full knowledge to purchase stock in such highly risky companies. A more stringent equity capital rule, as proposed above, would in turn make it less easy even for these companies to gamble to the creditors' detriment. Commercial banks, however, should be allowed to conduct normal proprietary trading, in particular the purchase of shares of stock and bonds of companies in the real economy, in order to reduce the vulnerability of the banking system to a crisis in the interbank market.

#### BANNING SHORT SALES

The need to rein in hedge funds and other financial institutions also results from the problematic effects of short sales. Short sales not only top-

pled the pound sterling. They also played a major role in the collapse of Lehman Brothers and therefore are at the centre of the current crisis.

A short sale is speculation on a falling price, often a share price. The speculator borrows a large number of shares of a particular company and sells them. Because of its large volume, the sale significantly reduces the share price and raises the expectation of a further decline in this price. This induces a herd reaction with many shareholders trying to get rid of that particular share, which reduces the price further and triggers a downward spiral. When the pessimism is at a maximum and the price correspondingly low, the speculator repurchases the shares and returns them together with a fee to the original lender.

Speculating on falling prices is not a problem *per se*. Someone who sells a share forward is also speculating on a falling price. He promises today to sell the share at a particular point in time at a pre-agreed price and buys the share on the stock market when this time comes. He, too, profits only if the future share price (the spot price) falls after the contract is made, but unlike in the short-sale case he is unable to bring about this price drop through his own actions.

The fundamental difference between a forward sale and a short sale is that the prices are stabilized in the first case and destabilized in the second. The forward seller stabilizes future share prices, as the transaction, which brings profits, drives the share price in the direction of the forward price. The more speculators engage in forward transactions, the stabler the stock market. Forward speculators destroy their own business through their activity, but that is the very reason why they stabilize the market.

The situation is different with respect to short sales. Initially the sale of the borrowed shares depresses the stock price, and then the repurchase increases it again. There is a downward and upward movement of the price that would not have existed in the absence of short sales. This is why short sales destabilize the market. From the perspective of an individual speculator, at first glance the short sale offers no advantage over forward speculation.

However, the crucial difference is that the short seller moves the market, because he trades with huge quantities of shares that he has borrowed. The sheer quantity gives him market power, enough to trigger a price decline that sets in motion the reinforcing herd reaction. By creating the conditions for a favourable repurchase of the shares, a short sale offers the speculator more chances for profit than a forward sale. But it is precisely this condition that raises doubts about such actions from an economic point of view.

Whenever an individual market participant can move the market price through his own actions, there is something wrong with the allocation of economic resources. A market economy functions well with atomistic competition where the participants are price takers, but not when they have enough power to change the nature of the market equilibrium. Market power usually leads to economic inefficiency and welfare losses. Since the private advantage of short sales exceeds the private advantage of forward sales only if market power is exerted, short sales do not offer any additional economic gain above forward sales. They ought to be limited, if not prohibited outright.<sup>21</sup>

#### A NEW BUSINESS MODEL FOR THE RATING AGENCIES

The rating agencies failed miserably in the current crisis. If, by way of a cascade of securitizations, housing loans with an average rating of B+ were converted into far more valuable instruments, 70 per cent of which were rated AAA, something must have gone wrong with the rating process. The same applies to the fact that Lehman Brothers was still rated A+ in the week preceding its demise. Given these facts, suspicion of opportunistic conduct on the part of rating agencies cannot be dismissed out of hand.

An obvious reason for the overly optimistic ratings given by the rating agencies to the investment banks and their CDOs is that they were paid by the banks whose products they rated. They even helped them to structure the CDOs in such a way as to yield as many desirable AAA ratings as possible. This is akin to the automobile club being not an association of car owners, but one that is paid by the automobile companies for help in designing the cars and subsequently testing and positively rating them.

The institutional conditions in the rating market are hair-raising and unacceptable from the point of view of bank customers and of the European competitors of American banks. To render the rating market operational again, four requirements should be met.

<sup>21</sup> Moreover, higher risk weights imposing higher minimum equity constraints are generally appropriate for bets on falling prices because such bets can easily involve losses that far exceed the transaction volume, creating the incentive to excessive gambling with limited liability. See H.-W. Sinn, *Economic Decisions under Uncertainty* (North Holland, Amsterdam, 1983), 288-94.

First, the rating agencies must no longer be involved in the structuring of the securities they are rating. As this was an important part of their business in the past, the corresponding business divisions must be spun off and managed as independent service companies.

Second, while the service companies can continue to be paid by the sellers of financial products, the rating agencies themselves should get their money from the buyers and/or from the government, due to the public goods nature of their services.

Third, the rating agencies must themselves be subjected to supervision, so that the criteria according to which they determine their rating categories will be completely transparent.<sup>22</sup> Basel III should draft a regulatory system for this.

Fourth, a European counterweight to the American rating agencies could be established so as to provide at least some international competition and break the problematic dominance of the US institutions. The EU could help in this endeavour, considering the public goods nature of the rating function.

#### STOP SIGNS FOR NON-RECOURSE CLAIMS

The securitization process supported by the questionable ratings was itself a problem. Mortgage-backed securities were claims against non-recourse claims against homes that often were undercollateralized because of the common practice of cash-back sales and because of the inclusion of fees in the reported home value. CDOs based on MBSs, in turn, were even more dubious constructs, as their returns were further diminished by frequent fees and involved a chain of interwoven claims that often even the cleverest experts were unable to understand. The American market for mortgage-based financial products was a gigantic market for lemons that dwarfed the used-car market, on which Akerlof's theory had originally focused, both with respect to its volume and with respect to the lack of transparency regarding product characteristics. Small wonder that the market for annual issues of MBSs and CDOs has virtually disappeared in

<sup>22</sup> Greater transparency of the rating agencies is also demanded by the Issing Committee. See O. Issing (chairman) *et al.*, *New Financial Order: Recommendations by the Issing Committee*, Center for Financial Studies, White Paper no. II (February 2009), 21-3.

the crisis and that US mortgage finance had to be socialized. Drastic intervention by the regulatory agencies is needed in this market in order to create the transparency, accountability, and liability that are the precondition for buyers to regain their trust in such products.

Multi-stage securitization beyond simple CDOs should be prohibited entirely. Even at the first CDO stage, the buyer has a hard time finding out the probability of repayment in the various tranches and determining against whom he is acquiring claims. Multiple securitizations beyond that, sometimes six and even forty stages, are absurd and fulfil no economic function whatsoever. They are nothing but trickery to exploit the excessively lax and fragmentary rules of the supervisory systems. However, this is not enough to revitalize the US capital market. Three further measures are advisable.

First, non-recourse mortgage loans should be eliminated to ensure that the homeowners remain responsible for the repayment of their loans with all their assets and cannot simply return their keys if house prices or the economy nosedive. The legal possibilities offered by private insolvency rules suffice entirely to protect homeowners from claims that would push them below the subsistence level. It is clear that this would trigger a minor revolution in the USA, but it is unavoidable if American mortgage-based securities should ever be sold again at substantial quantities in world markets.

Secondly, it should be stipulated in the Basel III system that every institution that securitizes claims must keep a certain fraction of them in its own books, say at least 20 per cent. If the American mortgage banks pool their credit claims in order to generate ABSs, they must keep at least 20 per cent of these securities. And if an investment bank constructs a hierarchy of structured claims out of such ABSs according to the waterfall principle, it must also keep at least 20 per cent of such securities and must do so out of each tranche that it creates. This rule will induce the participating bank to be much more circumspect in lending to the homeowner and also in selecting the mortgage claims it uses to construct the CDOs.

Thirdly, the investors in the financial markets could be encouraged to avoid non-recourse securitization entirely by developing an international market of covered mortgage bonds. As explained, covered mortgage bonds are not only secured by the collateralized properties (as securities are), but in the first place represent legal claims against the issuing banks. To develop such a market, a legal framework could be created in the Basel III system that would determine uniform minimum standards for covered mortgage bonds. As such bonds, thanks to being triply covered by bank, homeowner, and property, will presumably enjoy the highest creditworthiness of all privately issued securities, there will be no lack of demand for them.

**BURYING GRAVEYARD INSURANCE**

A final issue concerns credit default swaps (CDSs), guarantee-like credit insurance that has taken on a life of its own in a rather opaque way. This market is the most obscure of all, as it is not subject to any regulation, has taken on dubious forms, and has become so huge, with a volume of about \$30 trillion most recently, that the worst would have to be expected for the world economy if big collapses, with domino effects, were to occur. The fact that AIG specialized on CDS insurance because it was able to exploit a regulation gap and had to be nationalized in 2008 after incurring an annual loss of \$100 billion, the highest loss of any private firm in history, speaks volumes.

Of course CDS contracts also have benefits. By insuring banks against the default of their debtors, they promote a more productive risk-taking and lending in the real economy that boosts economic growth and contributes to the prosperity of nations. So care is needed not to throw out the baby with the bathwater. However, in view of the huge negative externalities that CDS insurance potentially imposes on other parties, as shown by the AIG case, prudence-fostering regulation that keeps these externalities under control is indispensable. Certainly, high equity-asset ratios are also necessary for the CDS insurers to induce a more cautious business strategy and make sure that they can meet their payment obligations even in a systemic crisis.

Moreover, a rational strategy for eliminating unnecessary CDS risk includes the creation of an international supervisory body that registers and examines the various hedging contracts that exist today. The contract claims could then be offset against each other and simplified in part in order to sharply reduce the total volume of CDS contracts. Initial approaches in this direction, in the form of privately initiated clearing actions, are already under way in the United States.

It is paramount, however, to prohibit mere betting on the demise of firms or on other events that do not directly affect the contracting parties. Such gambles create risks rather than eliminate them. In their graveyard insurance guise they are even highly dangerous, as they may trigger mayhem in the financial markets. They were created by financial institutions having limited liability and working with minimum capital stocks, well-known features that lead to gambling at the expense of other market agents and the economy as a whole. To limit the misuse of CDS contracts, the contracting parties must be able to prove that the insurance buyer has an insurable interest in the sense that he would suffer a loss from the insured event

that exceeds or equals the contracted indemnification payment. The prevalence of an insurable interest combined with the exclusion of overinsurance is a self-evident requirement for any normal insurance market, which, unfortunately, is rarely met in the CDS market. To ensure that such conditions are met, a reporting system for CDS contracts and an international register for such contracts should be established. This register should contain a convincing description of the insurable interest and a proof that overinsurance can be excluded.

Sometimes it is claimed that in CDS gambles the invisible hand was acting in a beneficial way that was just not yet understood by economists, sufficient reason for the markets to be left alone. In view of the obvious externalities resulting from limited liability, asymmetric information, and the expectation of government bail-out, I find this claim surprising. It reminds me of Voltaire's satire directed against Leibniz, *Candide, ou l'optimisme*, in which Dr Pangloss argues that everything that exists is good and has a purpose, which may be seen by looking at the nose, an appendage obviously shaped in the best possible way to support glasses.<sup>23</sup>

On the American life insurance market, graveyard insurance was prohibited back in the nineteenth century in order to prevent such problematic behavioural effects, and insurance contracts nowadays are only legal when they cover an insurable interest. Society is learning from its mistakes. The lesson to be learnt from the current crisis is that we cannot let people continue to play Wild West games on modern financial markets.

<sup>23</sup> 'It is proved', said Dr. Pangloss, 'that things cannot be other than they are, for since everything was made for a purpose, it follows that everything is made for the best purpose. Observe: our noses were made to carry spectacles, so we have spectacles...', cited from English edn.: Voltaire, *Candide: Or Optimism* (Penguin, London, 1947), 20.

# THE PROXIMATE AND REMOTE CAUSES OF A CRISIS FORETOLD: A VIEW FROM SOCIAL CATHOLIC THOUGHT\*

STEFANO ZAMAGNI

## 1. INTRODUCTION

The financial crisis which began in summer 2007 in the USA and then spread contagiously throughout the rest of the world, is systemic in nature. Indeed, it is not a local or regional crisis. It is the inevitable point of arrival of a process which, for more than thirty years, has changed at its very roots finance's way of being and doing, thus undermining the very bases of that liberal social order which is at the core of western civilization. The nature of the causes of the crisis is two-fold: the immediate ones, which speak of the specific characteristics adopted in recent times by the financial markets, and the remote ones, which blame aspects of the cultural matrix which accompanied the transition from industrial to financial capitalism. From the moment in which that epoch-making phenomenon which we call globalization began to take shape, finance not only constantly increased its quota of activity in the economic sphere, but it has progressively contributed to transform both people's cognitive maps and their value systems. It is to this latter that one refers today in speaking of the *financialization* of society. 'Finance', literally, is everything that has an end; if this escapes from its historical river-bed, finance can only produce perverse effects.

In what follows, I will briefly, for reasons of space, dwell first of all on the proximate causes of the crisis and then on the remote ones. I will not concern myself either with the many effects of the actual collapse that is sweeping across the world, nor with the ways out of it. On both of these

\* I would like to express my gratitude to the participants to the Plenary Session of PASS for their most valuable remarks on a previous version of this essay.

issues the contributions are lined up by now. My intention is not so much to add statistical-economic evidence or further descriptions of the mechanisms to the now vast, detailed literature about the subject (Morris 2008; Prasad 2009; World Bank 2008; Blanchard 2008; W. Sinn 2010; J.T. Raga 2010), but rather the wish to make emerge, from the facts which recount the financial disaster, that misleading ideology – disguised as apparently scientific – and that specific school of economic thought, dominant today, known as *mainstream* economics, from which market agents, government authorities, and controlling agencies have drunk. It is an ideology which, starting from the anthropological assumption of *homo oeconomicus* – which is an assumption, note, and not a proven proposition – or rational egoism, comes to the conclusion, after a long journey strewn with subtle theorems and econometric investigations, that the markets, including the financial ones, are institutional setups capable of self-regulation, and this in the dual sense of bodies capable of giving themselves rules for their own functioning and also of ensuring that they can be enforced.

The bridge which links that assumption to such a conclusion is the ethos of efficiency (P. Dembinsky 2010) the real and proper regulative principle of post-modern society. Notwithstanding the conventional view to the contrary, efficiency is not a value-neutral concept. For it postulates Benthamite utilitarianism as an ethical precept. Whether one adopts Pareto's ordinal version or the cardinal notion of efficiency, defined as a measure of the gap between a given result and the first best solution, utilitarian philosophy is always the frame of reference. Needless to say, there is nothing wrong in proclaiming one's adherence to utilitarianism, provided one does not pretend to consider it as a positive instead of a normative category of discourse. It is from the pervasiveness in present day economic culture of the principle of efficiency that comes that 'performative myth' for which to say means to do, and therefore something becomes *real* through the mere fact that *we do it*. It is this general mindset which provided the fuel for the speculative machine which was well able to make use of financial instruments and products with a 'fire-power' never before seen. Think only of automatisms such as computerised program trading, somewhat analogous to a particle accelerator, which amplifies, in a pro-cyclical way, the tendency to rise and fall of the exchange market. But it is clear that a speculative bubble of proportions like the one we know today would not have been able to happen without that 'mental bubble' which made many people believe it was possible to reduce the risk to zero, whenever they might succeed in spreading it in an appropriate way among a sufficiently high number of operators.

But the risk, when it is partly endogenous in nature, as it is financial risk, can be moved or reduced, never annulled, as we will see. Such a sense of omnipotence, supplied over the years by financial euphoria, took over the mental habitus not only of the traders and financial institutions, but also of the political authorities, media centres, and not a few university and research circles. The self-referencing of finance – finance which becomes an end to and in itself – has meant that Plato's maxim has been forgotten: 'The only good coinage with which it is necessary to change all the others is *phronesis*, wisdom which remains on guard'. A maxim which the illustrious American economist J.K. Galbraith rendered fairly prosaically thus: 'It is good that occasionally money is separated from the imbeciles'. And it is good that this happens, because it is many innocent people who have to pay for the *hybris* of the imbeciles in the sense of Leon Bloy. As history teaches us, the *phronos zeon*, the anger of the gods which accompanies the *hybris*, always falls on the last and the most vulnerable, and it is simply scandalous that this can happen in societies which call themselves open and civil.

Benedict XVI's encyclical *Caritas in Veritate* (CV) does not forget – nor could it forget – to 'read' the current crisis. It does this by advancing an unconventional interpretation of it, based on the astonishing paradox according to which a substantial increase in aggregate wealth goes hand in hand with an increase in global inequality – though with a decrease in absolute poverty. The tremendous increase in economic interdependence, following globalization, is the major factor determining the explosion of pecuniary externalities, to which economists continue to pay much too little attention. Without denying the importance of technological externalities (the most relevant of which are those affecting the environment), the time has come to switch attention to pecuniary externalities; whence the proposal in CV for a global governance but of a subsidiary and polyarchic nature.

To characterize the nature of pecuniary externalities, it might be of interest to recall what Adam Smith wrote in *The Wealth of Nations* on the consequences of the discovery of America and the passage of the Cape of Good Hope – 'The two greatest and most important events recorded in the history of mankind' (Smith, 1950, vol. 2, p. 141). Dealing with the consequences of these events, Smith remarked: 'What benefits or what misfortunes to mankind may hereafter result from those great events, no human wisdom can foresee. By uniting, in some measure, the most distant parts of the world...their general tendency would seem to be beneficial. To the native, however, both of the East and West Indies, all the commercial benefits which can have resulted from those events have been sunk and lost in

the dreadful misfortunes which they have occasioned...At the particular time when these discoveries were made, the superiority of force happened to be so great in the side of the Europeans, that *they were enabled to commit with impunity every sort of injustice in those remote countries*. Hereafter, perhaps, the natives of those countries may grow stronger, or those of Europe may grow weaker and the inhabitants of all the different quarters of the world may arrive at that equality of courage and force which...can alone overawe the injustice of independent nations into some sort of respect for the rights of one another. But nothing seems more likely to establish this equality of force than the mutual communication of knowledge and of all sorts of improvements which an extensive commerce from all countries to all countries naturally, or rather necessarily, carries along with it' (*ibid.* p. 141 italics added). I consider this passage a remarkable anticipation of the argument according to which nowadays we need a more balanced (and wise) approach in order to acknowledge both the gains and losses from globalization. Indeed, if it is certainly true that today we enjoy enormous 'gains from trade', it is also the case that we are facing 'pains from trade'. It is not acceptable that only the first component ('gains from trade') is taken into consideration in the public debate.

## 2. ON THE PROXIMATE CAUSES OF THE CRISIS

Allowing the subprime mortgage loan sector to become a real financial casino is certainly one of the first immediate causes of the current crisis.<sup>1</sup> In the USA, house ownership went from 44% in the 1940s to around 66% in the 1970s, a period during which no particularly significant losses or gains were registered. Up to 1969, Fannie Mae was a government agency, whose function was, on the one hand to buy loans from the banks and other savings administrators to allow them a constant flow in the supply of loans, and, on the other hand, to fix the benchmarks. At the same time, Fannie Mae was financing its operations selling bonds on the finance market. The situation began to change at the end of the 70s, when private operators on Wall Street, trying to emulate Fannie, packaged convertible loans into

<sup>1</sup> Already in 1926 J.M. Keynes anticipated that 'when accumulation of capital in a country becomes the by-product of the activities of a casino it is possible that things go wrong'.

bonds, creating products that were ever more convenient because they were riskier. In order not to lose market shares, Fannie ended up doing the same, thus sustaining the spiral of abuses.

In what sense can one speak of abuses? To respond to this, remember that according to the accounting rules in force, banks are obliged to register as assets on their balance sheet any loans granted. But doing this, banks discovered that they soon reached the threshold of the minimum capital which the supervisory authorities order them to have available to cover withdrawals. Furthermore, they also discovered that such an obligation constituted an effective impediment to the increase in the volume of dealings and therefore in their own profits. The bravura – so to speak – is therefore the transformation of liabilities into assets, conferring on clients' debts the quality of shares which, as such, can be re-sold on the financial market. And therein lies the meaning of that peculiar invention which is securitization. Securitization provides for the issuing of CDOs (*Collateralized Debt Obligations*), first introduced in the USA in 1987, through vehicle societies (*SPV, Special Purpose Vehicles, and Conduit*) or *Asset Backed Commercial Paper*, short-term securities guaranteed by banking assets, or again by re-securitization, operations in which the underlying assets are structured securities. Born as instruments to hedge from credit risk, derivatives have seen a powerful expansion over the last few years: from about \$100,000 billion in 2001 to more than \$600,000 billion at the end of 2007. In relative terms, the more substantial growth was that of CDSs (*Credit Default Swap*), which in the same period went from \$750 billion to about \$59,000 billion – almost four times the USA GDP.<sup>2</sup>

As N. Linciano (2008) explains, unlike what happened in the traditional manner with distribution of credit – a way which imposed maintaining in the budget loans granted to clients, i.e. the so-called 'originate and hold' model – the new way that gradually affirmed itself in the last quarter of the century, known as OTD (*Originate To Distribute*) model, says financial support granted can be securitized or spread out among a vast group of agents. This new way, which at the start was greeted with sympathy, since it was able to loosen the constraints of access to credit on the part of the poorest sectors of the population, in time ended by profoundly changing banks' approach to credit (they were interested in transferring increasing quotas of their own investments to other financial institutions) and incentivising

<sup>2</sup> For the details, see Mason (2009).

opportunistic and irresponsible behaviour. The reason soon became evident: the opportunity to transfer down the distributable financial risks notably reduces the bank's interest in monitoring the possibility of reimbursing debtors.

Faced with such a new situation, the American authorities not only did not intervene to at least try and guarantee respect for standards, but what is worse they left to private rating agencies the task of deciding for themselves the level of security for the new financial instruments. Bear in mind that derivative products such as CDSs are negotiated in non-regulated and above all non-controlled markets, with over the counter operations among banks. This allows less competition, and higher profit margins, but prevents evaluating the risk of the partner. Securitization thus began to spread like an oil stain, with the subprime mortgages acting like a fly-wheel within the process. Private enterprises, recognised by the US government, like Moody's and Standard and Poor, but not subject to any regulation, attribute ratings to various debenture loans to safeguard – so to speak – the public faith of subscribers. But given that the controller is remunerated by the controlled, it is obvious that it is sufficient to pay well in order to obtain a high rating – the well known 'Triple A' – even if the underlying loans bear high risks.<sup>3</sup> Today we are able to say that without the collusion of the rating agencies the sub-prime phenomenon would not have been revealed in the violent manner we now know, because it would not have been able to reach the critical mass and above all would not have been able to feed those herding phenomena, which hook speculative bubbles.

Spontaneously the question arises: why didn't the public regulators intervene in time to modify the legislation in force in order to put an end to the conflict of interest which involved most of the rating agencies? This is the second immediate cause that we are concerned with. The fact is that neither the government nor the American Congress have ever decided, before now, to intervene in this area. To tell the truth, once in 1994 the Democratic Congress, sensing the seriousness of the problem, approved a law on 'Homeownership opportunity and equity protection' which obliged the Federal Reserve to fix standards for mortgage lenders who were not subject to any other specific form of regulation and ensure they were respected. But Alan Greenspan, the powerful FED President (1987-2006), blinded by the ideology of the 'Objectivist Movement' founded in the early

<sup>3</sup> Consider that on the eve of its failure, Lehman Brothers had obtained an A!

fifties by Ayn Rand, an influential Russian writer emigrated to the US and author of *Atlas Shrugged* (1952) and of *The Virtue of Selfishness* (1957), repeatedly refused to implement that law. The argument used was that the exchange of derivatives happened between highly qualified professionals who certainly had no need for safeguards. Moreover, self-regulation was the only safe basis for a modern financial system, since the greed attitude by financial agents was the most effective self-defence mechanism.

This trust Greenspan grounded blindly on the famous Black-Scholes-Merton model for determining the value of derivatives. A model according to which it was sufficient to look at the price of an asset and not also at the risk which it bears to give fair value to another asset – let's say, an option – which travels on its back. This is one of the major consequences of the celebrated Efficient Market Hypothesis (EMH) that has dominated financial economics, according to which markets tend, naturally, to equilibrium and shares are always correctly priced. How can such a small miracle happen? Simply because EMH does not connect the excessive movements of asset prices to financial risk. By suggesting to banks and regulators to adopt the so-called value at risk model – according to which risk is calculated on the basis of minor deviations around the equilibrium value of asset prices – the risk associated to strong oscillations of long-run prices can be forgotten. As shown in Frydman and Goldberg (2007), already scholars such as F. Knight, F. von Hayek, H. Minsky, among others, had warned against such a methodological mistake. Which led to what Greenspan called – after he had stepped down as chairman of US Federal Reserve – the 'underpricing of risk worldwide'.

An important sign of the serious *aporia* contained in the model could already be seen in 1998 – the year after Scholes and Merton received the Nobel Prize for Economics – with the failure of LTCM (*Long Term Capital Management*), the hedge fund on whose managing council sat both scholars. But even faced with such evidence, Greenspan did not deem it necessary to intervene, apart from changing his mind a few years later as we shall see in Section 4. Not even in 2002, when the Sarbanes-Oxley law was approved after the famous 'corporate scandals' (Enron and Worldcom in 2001), was the opportunity taken to provide a remedy to the increasing conflicts of interest among the heads of both rating agencies as well as many financial promoters 'advising' clients to buy securities which only a short time afterwards would be useless. As one can verify, the Sarbanes-Oxley bill was concerned with conflicts of interest in the governance of corporations, but paradoxically excluded from its sphere of application the rating agencies and the enterprises dedicated to financial intermediation, with the

result that these subjects acquired such an influential power on politics that one could forget the famous principle of separation of powers on which the liberal model of social order is based. Moreover, it is necessary to say that perhaps the same public regulators were not in a position to know, with some approximation, the actual volume of the speculative transactions. The reason soon became clear. At the end of the 90s, commercial and investment banks began to start a large number of off-budget entities sponsored by one or more of them. These are the so-called OBSE (*Off-Balance Sheet Entities*): autonomous bodies which do not appear in the balance sheet of the sponsoring banks, to which they pay huge commissions. Such are the carrier vehicles for special motives which, once created, move into a shadowy cone which makes them completely opaque to the outside observer. In such conditions, to speak of transparency in favour of savers is no more than wishful thinking.

A third proximate cause of the financial crack must be cited, i.e. *leverage* excess. Remember that the volume of speculative transactions in the course of the last quarter of a century has been carried out almost entirely with money taken on loan. A normal leverage relationship for a hedge fund or private equity fund is of the order of 30 to 1 – that is \$30 debt against \$1 of real capital.<sup>4</sup> Well, in the financial institutions dedicated to sub-prime mortgages, in the last few years the leverage relationship became practically infinite, given that such institutions had a real capital tantamount to zero. What the USA are now waiving was an era of financial thoughtlessness: credit purchases with no cover; mortgages granted to everyone on the entire value of the property; credit cards distributed to whoever; recourse to hyper-sophisticated financial instruments. Up to a certain point, the game ensured astronomical profits – or it would be better to say rents – but as soon as investors began to look inside the black box panic set in. To be precise, things started to go wrong when, beginning in 2005, the increases in interest rates decided by the FED made the rate of sub-prime mortgages more onerous, which increased the risk of insolvency among the more exposed, most vulnerable families. The lack of a secondary CDO market – one recalls that it is thanks to the CDO that American banks were able to grant mortgages with open arms – meant there was no smooth adjustment of their prices to the new

<sup>4</sup> Five years ago Morgan Stanley was one of the five large American investment banks which obtained from the SEC dual authorization to go into debt up to a relationship of 40 to 1 with respect to its capital and to substitute external controls with self-regulation.

conditions of risk. When insolvency became obvious, the price adjustment happened all at once, thus causing wild devaluations – even excessive – in the operators' assets held in the CDO portfolio. Collapse was an immediate and logical consequence (Cooper 2008).

It is known that ever since money was invented, men have dedicated themselves to producing counterfeit money. At the time of metallic circulation, this happened by defrauding on the amount of precious metal contained in coins; then, with the excessive issue of banknotes; today, by the inflation of credit. As already anticipated in the 1940s by the French economist Jacques Rueff, today the refined way of creating false money is that of launching a speculative bubble. Alexandre Dumas, in his book *The Black Tulip*, describes with the pen of a great writer and with great anticipation of time, the mechanics of speculative logic with reference to the first great speculative bubble of 1636-37, known as 'tulip mania'. After various attempts down the centuries, it can be said that the world of finance has succeeded, at least in part, to subtract from the State and politics the power of monetary control. That is why the current crisis will find no definitive solution until politics and civil society do not take back in hand the governance of financial activity, directing it to its natural goal which is that of being at the service of investments, production, exchanges. According to the famous saying of Baron Luis: 'Give us good politics, and I will give you good finance'.

What has been said heretofore brings me to the fourth of the proximate causes: the 1999 abolition of the 1933 Glass-Steagall law which sanctioned the separation between commercial and investment banks – the former subject to massive controls; the latter to more bland forms of control. The wind of Reaganesque deregulation blew so strongly that it armed Gramm-Leach-Bliley to whom that abolition is due. The outcome was easily imaginable. Not content with that, Gramm set himself up as champion of the law on *Commodity Futures Modernization* signed by President Clinton on 21 December 2000, just before leaving the American presidency. The effect of that norm was to remove derivative financial products from the regulation and supervision of both the SEC and the Commission for the Commerce of Futures, which allowed an unprecedented expansion of derivatives exchanged outside the stock exchange market. Just to give a rough idea of the increase in the volume of business associated with derivatives, consider that from 2000-2007 the subscription value went from \$100 trillion to \$600 trillion, a figure which corresponds to about 10 times the world GDP (Shiller 2008).

To the investment banks therefore were added hedge funds and private equity funds that created credit outside the banking channel and speculated on the financial markets with loaned money. According to the opinion of the president of the House Banking Committee, Barney Frank, more than half of the credit created in recent years comes from institutes not subject to any regulation. But there was no need to get alarmed – or so it was thought – because on various occasions the Bush administration stated that these new financial players offered transactions to consenting adults aware of the risk they might have to face. One doesn't need to have any great economic preparation to understand that reasoning of that kind completely forgets to take into account the indirect effects which fall on subjects who have not taken part in the transactions and which are called, in economic theory, pecuniary externalities. It is a sad fact that economic theory, while devoting great attention, at least from the time of Pigou, to technological externalities, barely mentions pecuniary externalities, whose massive presence in an economy jeopardizes the sustainability of the liberal model of social order. To tell the truth, in 2005 Greenspan had addressed to the Senate Banking Committee the invitation to take into serious consideration the level of risk to which Fannie and Freddie were exposing the whole system, but the measure which some Republican members of Congress had suggested for such a need was never voted on, due to the strong opposition, too, from the Democratic Party.

I would like to conclude this section by suggesting that the proximate causes described above point to the failure of the doctrine that has become dominant among economists at large in the last quarter of a century. I am referring to the doctrine characterized by two different and fallacious approaches. The first: assuming perfect competition in all markets capable of achieving social desirable outcomes, there is no need to consider the possibility of economic agents' effective freedom of choice and their ensuing moral responsibility. The second: that doctrine legitimized self-interest and greed as *necessary* conditions for market efficiency (note that the conditions are not merely sufficient). In this perspective, the only duty of economic agents would be to act according to self-interest *only*, pursuing maximum profit and shareholder value maximization. The present crisis is revealing how disastrous can be the effects of the concept of the merchandisation of the human person at the core of dominant economic culture.

### 3. THE REMOTE AND STRUCTURAL CAUSES OF THE CRISIS

The causes described in the previous paragraph are proximate because, although sufficient to unleash the current financial crisis, they are not also necessary. In fact the crisis would have happened anyway, albeit in a different form, and with disturbances different from those of the sub-prime mortgages. When the storm knocks down a house, the principal cause is the structural weakness of the building, even though it is true that without that disturbance even a house built on sand would have remained standing. The structural causes of the crisis will be grouped into three main blocks.

3.1. The first concerns the radical change in the relationship between finance and production of goods and services which has taken place in the course of the last thirty years. Starting from the mid-1970s, the majority of western nations packaged their promises of pensions in investments which depended on the sustainable profitability of the new financial instruments. At the same time, the creation of these new instruments gradually exposed the real economy to the whims of finance, generating an increasing need to set aside for remuneration of savings invested in them increasing quotas of value added. The pressure on businesses deriving from the stock exchanges and private equity funds transferred greater pressure in other directions: on directors obsessively induced to continually improving their management performance with the aim of receiving increased stock options; on consumers, to convince them, through the use of sophisticated marketing techniques, to buy more even in the absence of purchasing power; on businesses of the real economy to convince them to increase their shareholder value. And thus it happened that the persistent request for ever more brilliant financial results began to rebound, through a typical trickle down mechanism, on the whole economic system, until it became a cultural pattern. To pursue an ever more radiant future, the present was thus forgotten.

After more than thirty years of the diffusion and growing importance of financial activities in the economic system, the state of the economy shows worrying signs of weakness under three specific aspects. First, the diffusion and growing importance of financial activities in the economic system – which in order to function needs to include in its logic an increasing number of national economies – has progressively replaced intersubjective relations with anonymous and impersonal transactions. The limitless search for capital gains has meant that values such as loyalty, moral integrity, relationality, trust were gradually pushed aside to make room for principles of

action aimed at the pursuit of short-term results. In this way, it was possible to spread the disastrous conviction on the basis of which liquidity of financial markets would be a perfect substitution for trust. At the same time, since the stock exchange value is all the investor is held to consider when he has to make his decisions, it seemed that growth could easily be built on debt: this is the ultimate meaning of the process of the diffusion and growing importance of financial activities in the economic system.

What is the really dangerous consequence of this 'new' culture? That of distorting the way of conceiving the link between earned income and income from speculative activity. If the diffusion and growing importance of financial activities in the economic system is sufficiently achieved – it was believed – there is no need for families, in order to provide for their own needs, to draw mainly from their own salaries and wages. Dedicating themselves to speculation, they can obtain by other means the necessary income to attain increasing levels of consumption. What's more, if and according to the measures in which wages reductions encourage the profitability of businesses quoted on the stock exchange, it can happen that families can more than compensate for the reduction in earned income through increases in stock exchange income. In such a way, the conflict endemic in post-modern society, between the figure of the worker and the consumer – in order to produce shareholder value businesses must restructure with operations such as outsourcing, mergers and acquisitions, because that reduces not just the salary but also the price of consumer goods – would be solved by the figure of the investor-speculator. The diffusion and growing importance of financial activities would induce the small or large saver to become a speculator, shrewd or otherwise.

So we must not be surprised if, in the course of the last quarter of a century, on the one hand the volatility of work relations (known as precariousness, which has very little to do with flexibility) has increased to levels unseen ever before, while on the other in all the developed countries of the West the inequality in income distribution has increased. As the October 2008 OECD Report (*Growing unequal? Income distribution and poverty in OECD countries*) tells us, the gap between the rich and poor has noticeably increased in the period indicated. It is easy to understand the chief, but not the only reason for this: when income comes from work (manual or intellectual) the gap between the higher and lower paid people will never go beyond a certain threshold; this is not the case when the income comes from speculative activity or when some remuneration is linked, as happens in the case of directors' stocks options, to stock exchange trends. When the

unitarity of the person is artificially broken up in figures such as the worker, the consumer, the investor-speculator, the outcome can only be disastrous. Already J.M. Keynes in the well-known essay *The end of laissez-faire* (1926) had identified with clarity and foresight that the causes of the 'greatest economic evils of our time [lie] in the great inequality of riches which happen when particular individuals, benefitting from positions or particular abilities, succeed in gaining an advantage from uncertainty and ignorance and when, for the same reasons, the corporations often become a lottery which makes reasonable business expectations fail'. Whence Keynes's dictum that 'economics is a moral and not a natural science'.

The third sign of worrying weakness I hinted at above is the spread at the level of popular culture of the ethos of efficiency as ultimate criterion of judgment and justification in the economic activity. On the one hand, that led to the legitimisation of greed – which is the best known and most widespread form of avarice – as a sort of civic virtue: the *greed market* substituting the *free market*. 'Greed is good, greed is right', cried Gordon Gekko, the protagonist of the famous 1987 film, *Wall Street*. On the other hand, the ethos of efficiency is at the origin of the now systematic alternation between greed and panic. As more than one commentator has tried to explain, it is not to be concluded that panic would be a consequence of irrational behaviour on the part of the economic agents. Panic is no more than euphoria with minus sign up front; therefore, if euphoria, according to the prevailing theory, is rational, so is panic. The fact is that it is the theory which is aporetic, as I will explain in the next paragraph.

3.2. But how has the process described in so far been able to reach the level of pervasiveness and incidence that we are all aware of today? Without the scientific support of a certain school of economic thought things would not have gone as they did. Before giving reasons for this statement, there is an indispensable premise. Unlike what happens in the natural sciences, economic science is strongly under the influence of the double hermeneutic, according to which economic theories about human behaviour impact, more or less, sooner or later, on the behaviour of man himself. Which is tantamount to saying that theorisation in the economic sphere never leaves its area of study unchanged, since it not only shapes the cognitive maps of the economic agent, but also indicates the way to follow if one wants to achieve the aim in a rational manner. Now, if the aim is maximization of profits (or some other specification of the objective function), and if, as is obvious, the aim of an action prescribes the actions required to achieve it, the hermeneu-

tic circle is soon closed. It is for this fundamental reason that the economist cannot take refuge behind a presumed axiological neutrality at the time of producing models and theories, above all when he/she is aware of the fact that the products of his/her scientific work produce a certain way of thinking and are taken as a point of reference by political decision-makers.

In the specific matter we are concerned with, where was the economists' absence of social responsibility chiefly shown, an absence which consisted in not having paid attention, at least, to the principle of precaution in suggesting certain courses of action? In the first place, in having credited the belief that efficiency is an objective criterion (that is, neutral with respect to value judgements) of choice between opposing alternatives. As clarified above, one can utilize the criterion of efficiency, and on account of it take decisions, only after the goal to be pursued has been fixed. This is tantamount to saying that efficiency is a means to an end and not an end in itself. Therefore to maintain that the behaviour of bankers and traders – who have thrown themselves en masse into the game of financial speculation in the last twenty years – is legitimized by their adherence to a criterion of rationality aimed at ensuring an efficient allocation of financial resources, is at least a tautology, a sign of glaring methodological naivety.

There is a second area in which the mainstream economic thought was decisive in contributing to defining the financial disaster: the theoretical background which strengthened the principle of maximization of shareholder value. In short, it is this. There are three conceptions with which the micro-economic theory looks at corporations: the firm as association; the firm as coalition; and the firm as commodity (Putterman 1988). The first sees the firm as community, in which various interested parties participate (workers; investors; clients; suppliers; territory), co-operating to attain a common objective, and which is organized to last some time. And this is the idea – note – from which the American 'corporation' was born, which in origin was a non-profit body the governance of which was borrowed from Benedictine and Cistercian monasteries. According to this view, the corporation is a good in itself and as such it cannot be left to whims of the market, particularly the financial market. The conception of firm as coalition, on the other hand, was developed from the pioneering contribution of the Nobel prize winner Ronald Coase, who in his famous 1937 essay *The Nature of the Firm* defended the thesis according to which the firm arises to save on transaction costs, that is the costs of market use. Every market negotiation, in fact, implies specific costs and therefore a firm has reason to exist as long as the transaction costs exceed the functioning costs.

Finally, from the 1960s in economics there began to take shape, until becoming dominant today, the idea of the firm as commodity, which, as such, can be bought and sold on the market like any other commodity. It is, therefore, nothing but a *nexus of contracts* which, depending on the conventions of the time, are initialled by a plurality of subjects each looking for maximum individual profit. Well, if the firm is nothing more than a commodity, it is obvious that the only class of stakeholder who merits attention is the shareholder, for the obvious reason that in order to sell one needs an owner, and, on the other hand, whoever is buying a firm, paying a price for it, becomes its owner. Should we be surprised, then, if starting from such a conceptualization of the firm, one concludes that the aim of management is that of maximizing the value for the shareholder-owner? One bears in mind that it is the principle of the shareholder's value which inspired in an ideological sense the process of the diffusion and growing importance of financial activities in an economic system. This is the principle which leads to enhance quotations on the stock exchange and assign all free cash flow to the shareholder – the cash which remains once all operative, financial and fiscal costs have been honoured. To increase the profits he expects to collect, the shareholder-owner of the firm takes managers into partnership through recognition of remuneration also linked to capital returns – stock options are the best known tool, but not the only one. If the management is not performative, the firm's quotations will fall and it will pass into the hands of others who will seek to remedy the loss of efficiency. But for all of this it is necessary to consider the firm as a commodity! Now, leaving out of consideration the abuses of power on the part of managers, very frequent in recent years, it is the theoretical foundation of shareholder's value which is too weak, as I have argued in Zamagni (2006).

Finally, it is worth saying something about a third precise responsibility of the profession of economists in this matter. As recalled in Section 2, the theoretical model on which the creative financial agents have built their edifice of structured securities – securitized loans, re-packaged in synthetic bonds as CDOs – is the famous Black-Scholes-Merton model, drawn up in the 1970s in the wake of earlier intuitions of R. Lucas, the noble father of the theory of rational expectations who received the Nobel Prize for Economics in 1995.<sup>5</sup> The aim of the model was to study the evolution over time of the price of the financial instruments and its main conclusion was that,

<sup>5</sup> Myron Scholes and Robert Merton received the Nobel Prize two years later.

under certain conditions, it is possible to eliminate the risk of investments. In the motivation of the Nobel prize written by the Swedish Academy in December 1997 one reads: 'Banks and investment banks regularly use the laureates' [Merton and Scholes] methodology to value new financial instruments and to offer instruments tailored to their customers' specific risks. At the same time they can reduce their own risk exposure in financial markets'. In the October 1997 edition of the *Bulletin* of the Harvard Business School – to where Merton had recently transferred from nearby MIT – one reads: 'In fact, using Merton's formula, it becomes possible to construct a portfolio that is virtually risk-free' (*sic!*). Why 'virtually'? For the simple reason that events which could invalidate the conclusions of the model were considered so rare that they could be forgotten. These are events of the 'black swan' variety – an expression which entered into common use from 1697, when a team of Dutch explorers came across a black swan for the first time in Australia.

Why has reality then 'disobeyed' the theoretical model? The answer comes from Alan Greenspan himself, who, having denounced in the *Financial Times* of 17 March 2008, 'the models too simplistic to capture reality', on 23 October 2008, before the American Congress Committee of Government Oversight and Reform, to the question raised by the chairman: 'You found that your view of the world, your ideology, was not right – it was not working?' answered: 'Absolutely, precisely. You know, that's precisely the reason I was shocked, because I have been going for forty years or more with very considerable evidence that it was working exceptionally well'.<sup>6</sup> He further added: 'In recent decades, a vast risk and pricing management system has evolved, combining the best insights of mathematicians and finance experts supported by major advances in computer and communications technology. A Nobel Prize [in truth, three Nobel prizes] was awarded for the discovery of the pricing model that underpins much of the advance in derivative markets. This modern risk management paradigm held sway for decades. The whole intellectual edifice, however, collapsed in the summer of last year because the data inserted into the risk management models generally covered only the past two decades, a period of euphoria' (*ibid.*). In other words: it's the black swan's fault! Nevertheless, already in 2007 in his bestseller *The Black Swan* Nicholas Taleb had anticipated what would then begin to happen from July 2008 onwards. When a single thought in management spheres emphasizes the role of debt as a determin-

<sup>6</sup> C-SPAN Video Library 281958, available at [www.c-spanarchives.org](http://www.c-spanarchives.org).

ing factor in creating value for shareholders it is obvious that the accounting principles – such as fair value, mark-to-market – are constructed as if the crisis was never to be here. And if it happened, it was the responsibility of the agents who behaved in an irrational manner!

To look at a comparison, it is interesting to re-read the conclusion reached in 1965 by Paul A. Samuelson in the famous article in which he introduces for the first time the ‘efficient markets hypothesis’, according to which asset prices reflect in each instance all the information available and the price of an asset is the best estimate of its intrinsic value and thus provide the proper signals for resource allocation. Having formally shown that the ‘movements of share prices follow a random walk, a process in which each variation is completely casual and unpredictable’, Samuelson concluded: ‘One should not draw too many consequences from the theorem I have just demonstrated. In particular, it does not follow that the real competitive markets work well’. An example, this, of intellectual humility and political wisdom.<sup>7</sup> In an interview published in the Italian newspaper *Corriere della Sera* of 20 October 2008 Samuelson stated: ‘I the undersigned and some colleagues from MIT and the Universities of Chicago, Wharton, Pennsylvania and many others, risk suffering some rude treatment when we meet St Peter at the gates of Paradise’ (p. 9). This statement forms a pair with that of Edmund Phelps, also a Nobel laureate, who in his article of 11 November 2008, published again in the *Corriere della Sera*, had written: ‘The banks have spoken about the decline in house prices as if it was the consequence of some shock...In fact there have been no earthquakes, periods of drought or other external factors to produce the fall in prices. The main cause was a forecast based on *completely erroneous*<sup>8</sup> theoretical models’.

Moving along a slightly different line, Nicole El Karoui, the famous French scholar from the University of Paris VI to whom we owe the mathematical infrastructurization of the random calculation on the basis of which derivative models were constructed, has stated: ‘I believe that in this crisis mathematicians have played the smallest role, even though I do not wish to deny every responsibility. At times they have behaved like engineers who design cars that are too fast...Perhaps mathematicians did not properly explain the risks of these products, but we are not the primary people

<sup>7</sup> Actually, as Shafer and Vovk (2001) later showed, Samuelson had demonstrated that the process describing the movement of share prices is a martingale and not a random walk (Cf. p. 227).

<sup>8</sup> My italics.

responsible for this crisis. The major investors who bought derivatives had the instruments to understand their significance' (*Il Sole 24 Ore*, 26 October 2008). The simile conveys the idea, but it's hardly fitting: first of all, because even an expert in mechanical engineering is in a position to evaluate the risks of excessive speed; secondly, because in the case of traffic circulation there are speed limits placed there on purpose. What's ultimately wrong in the Black-Scholes-Merton model? Two basic things.

The first one is that this model implicitly refers to a centrally planned economy. As clearly explained by Buitter (2009), the model under consideration utilizes dynamic optimization techniques in order to arrive at an equilibrium solution. As mathematical programming teaches, to achieve optimality one has to assume that the influence of the infinitely distant future on the objective function today is zero. Now, where does this terminal boundary condition come from? 'The terminal boundary condition that the influence of the infinitely distant future on asset prices today vanishes, is a transversality condition that is part of the necessary and sufficient conditions for an optimum. But in a decentralised market economy there is no mathematical programmer imposing the terminal boundary conditions to make sure everything will be all right' (*ib.* p. 4). This a sort of historical nemesis. The school of thought, known as The New Classical and New Keynesian Macroeconomics, which was established to exalt virtues and merits of extreme *laissez faire*, in order to arrive at its fundamental result has to refer itself to the functioning of a centrally planned economy! Indeed, as it has become clear by now, the rational expectations models – to which the BSM model belongs as a particular species – are the intellectual heirs of the central planning models developed after the Second World War and against which von Hayek fought so strongly (1945).

The second *aporia* present in the Black-Scholes-Merton model is that it is based upon two assumptions strictly linked to one another. The former is that the value of an asset over time follows a path which can be described by a Brownian motion; the latter is that the changes of value of the asset are so frequent, hence so numerous, that it is possible to apply to them the law of large numbers, i.e. Bernoulli's theorem. Both assumptions would obtain only if economic phenomena were stochastically independent – which is practically never the case.<sup>9</sup>

<sup>9</sup> I owe this remark to Domenico Costantini.

3.3. I move now to the third block of remote causes. They are all to do with the specificity of the cultural matrix which has gradually been strengthened in recent years in the wake of the globalization process on the one hand and, on the other, by the advent of the third industrial revolution, the info-telecommunications technological revolution. Two specific aspects of such a matrix are relevant to the present aims. The first concerns the acknowledgement that at the basis of the actual capitalist economy there is a serious pragmatic – not logical, it must be well understood – contradiction. The capitalist economy is certainly a market one, that is an institutional asset in which the two fundamental principles of modernity are present and operative: freedom to act and to do business; equality of all in the face of the law. At the same time, however, the main institution of capitalism – the capitalist enterprise, to be precise – has built itself up in the course of the last three centuries on a principle of hierarchy. Thus a system of production has taken shape where there is a centralized structure to which a certain number of individuals voluntarily surrender some of their goods and services, which once they have entered the enterprise escape from the control of those who supplied them, in exchange for a price (the salary).

We know well from economic history how that happened and we are also aware of the significant progress on the economic front which such an institutional asset has guaranteed. But the fact is that in the actual passage of time – from modernity to post-modernity – ever more frequent are the voices raised indicating the difficulties of democratic and capitalist principles being side-by-side. The phenomenon of the so-called privatization of the public is above all what causes the problem: the corporations of the capitalist economy are assuming more and more control of the behaviour of individuals – who, it should be noted, spend more than half their time at the workplace – removing it from the State and other agencies, and first of all, from the family. Notions such as freedom of choice, tolerance, equality in the face of the law, participation and other such things, coined and diffused at the time of civil Humanism and strengthened at the time of the Enlightenment, as an antidote to the (almost) absolute power of the sovereign, are, suitably re-calibrated, internalized by capitalist corporations to transform individuals, no longer subjects, into acquirers of those goods and services that they themselves produce.

The contrast deriving from this is that, if there are cogent reasons to consider the maximum extension possible of the democratic principle to be desirable, then it is necessary to begin to look at what happens *inside* corporations and not just at what happens in the relations among corpo-

rations which interact in the market. 'If democracy', wrote Dahl (1985), 'is justified in the government of the State, then it is also justified in governing the corporations' (p. 57). The society in which the democratic principle finds concrete application only in the political sphere will never be completely democratic. The good society in which to live does not constrain its members to embarrassing separations: democratic as voting citizens; non-democratic as workers or consumers. In his recent study (2008), Robert Reich – former minister in Clinton's first presidency – defends the thesis according to which positional competition today represents a serious threat to democracy. It's like saying that it's not true that it's the free market which is prodromal to democracy; on the contrary, it's the democratic principle which frees the market.

The second aspect regards the ever more widespread dissatisfaction about the way of interpreting the principle of freedom. As is known, there are three constituent elements to freedom: autonomy, immunity, and capacity [to act]. Autonomy speaks of the freedom of choice: one isn't free if one isn't in a position to choose. Immunity, instead, speaks of the absence of coercion on the part of some external agent. In large measure it is negative liberty (or 'freedom from') which Isaiah Berlin spoke about. Finally capacity (literally: the capacity to act), in the sense implied by Amartya Sen, speaks of the ability to choose, to attain objectives, at least in part or in some measure, which the subject sets himself. One is not free if one is never (or at least in part) able to realise one's life plan. Well, while the liberal-laissez-faire approach is able to assure the first and second dimension of liberty to the detriment of the third, the statist approach, both in the version of the mixed economy and in that of market socialism, tends to privilege the second and the third dimensions to the detriment of the first. Laissez-faire is able to support change, but it's not as capable of managing the negative consequences of change, due to the serious temporal asymmetry between the distribution of the costs of change and those of the benefits. The former are immediate and tend to fall on the shoulders of the more ill-equipped sectors of the population; the latter accrue later and benefit people with greater talent.

As J. Schumpeter was among the first to recognise, the heart of the capitalist system is the creative destruction mechanism which destroys 'the old' in order to create 'the new' and creates 'the new' to destroy 'the old'. In the words of Schumpeter: 'The kind of competition which really counts is not price competition, but competition which destroys the old commodity to replace it by the new one'. However, it's also its Achilles' heel, because unless

adequate 'safety nets' are created it's obvious that those who see themselves damaged by the mechanism of creative destruction will organize themselves to boycott it, creating neo-corporatist lobbies to block the process of innovation from taking place. Indeed, it's true that the creative destruction mechanism is an effective system for the creation of wealth, but it's also extremely brutal. On the other hand, market socialism – in its various versions – if it proposes the State as the subject entrusted to face the asynchronisms that have been spoken about, doesn't damage entirely the logic of the capitalist market, but it restricts its area of operation and incidence. As one can understand, the challenge is therefore that of making all three dimensions of liberty hang together: this is the reason why the paradigm of the common good appears as at least an interesting perspective to explore.

In the light of what has been argued before, we can understand why the financial crisis cannot be said to be an unexpected or inexplicable event. That is why, without taking anything away from the indispensable interventions in the regulatory area and the new necessary forms of control, we will not succeed in stopping in the future analogous episodes if the evil is not attacked at its roots, that is to say intervening in the cultural matrix which up to now has supported the economic system.

#### 4. THE MESSAGES OF THE CRISIS

What can be said in conclusion to these notes? That if the public protection constituted by the rules and the supervisory agencies – a protection which would have been able to stop the explosion of a financial crisis of proportions never seen before – has not worked, that is due to a variety of reasons, some of a contingent nature (cf. Section 2), others of a structural character (cf. Section 3). However, it is precisely the latter which help us understand how *this* crisis is different, in a qualitative sense, from those which preceded it.

When, since 1984, the majority of European nations started to follow the USA along the path of financial deregulation, perhaps no one had perceived the mortal danger that would have derived from it: the cutting of the link between democracy and the market. But a market which deletes democracy from its horizons in order to make room just for efficiency – taking the form of maximization of profits for shareholders – pushes the economy along a path of oligarchic development, which is as far as it can be from the liberal perspective. The paradox of *laissez-faire* – understood in

the strict sense – is that it cuts the branch on which it is sitting: aiming exclusively at efficiency, it forgets that democracy and freedom are values superior to it. This is why already Adam Smith insisted that an authentically liberal social order needed two hands to survive: one invisible – the most well known one, though often misunderstood, due to a lack in interpretative ability – and one visible – that of the State which has to intervene in a subsidiary key, as we would say today, every time the work of the invisible hand risks leading to monopolization or oligopolization of the economy. One fact in this regard: the first five American banks (Citigroup, Bank of America, J.P. Morgan, Wachovia, HSBC) control 97% of the derivative industry and shoulder 90% of the implicit risk.<sup>10</sup>

Today we are witnessing a sort of sentencing of retaliation. From as long ago as the great depression of 1929, one has never seen such a deployment of forces in the economy on the part of the public sector as the one currently in process. As reality teaches, when in the name of ideology one exaggerates in one direction, history's pendulum then swings inexorably in the opposite direction. The dual promise – of financial institutions, which would have been in a position to self-regulate themselves, and of economic results, which would have assured everyone returns above their own average – has been revealed for what it was and is: a tragic lie, even if masked and edulcorated with pseudo-scientific arguments. The most theatrical of them assumed the following syllogistic structure. To increase ever more the capital gains it is necessary to raise the levels of risk. On the other hand, *if* the highest risk thus sought is subdivided into myriad securities and financial vehicles; *if* the financial products thus created are spread over a sufficiently broad mass of investors; *if* the temporal horizon of economic decisions extends endlessly; *if* all three of these conditions are satisfied, then it is as if the risk was annulled and therefore forgotten. However, the statement according to which financial innovations increase overall efficiency insofar as they distribute the total risk over the market is true only if one can prove that risk is an exogenously given magnitude. Which is not the case for the simple reason that financial innovations themselves tend to generate new risk. In situations of this type, the positive effects associated to a wider distribution of risk are unable to compensate for the negative effects due to the endogenous increase of risk. Such a mistake is the consequence of the

<sup>10</sup> Bear in mind that in the 1776 *Wealth of Nations* the metaphor of the invisible hand was cited only once, while Adam Smith devotes quite a few pages to the modes of State intervention.

wrong assimilation of financial risk with natural risk (e.g. the risk of earthquakes, or other natural disasters). While the latter does not depend on the working of capital markets, the former heavily depends on it.

It doesn't take much to understand how the outcome of such a deception of reality was able to generate the situation of which we are sad spectators today. And yet, even the most naive economics student knows the economic law, the heritage of ancient wisdom, which says that the value of a complex financial product (think of the CDOs and CDSs) can never exceed the value of its weakest component – just as the strength of a chain is the strength of its weakest link. But *sacra auri famas* (the sacred hunger of gold) and ideologies have made hay of this and other basic economic principles (Zamagni 2009).

The crisis – which literally means transition and as such is destined to end (perhaps in the course of the next two or three years) – bequeathes to all the players a message and an important warning. To the commercial and investment banks and various financial institutions the invitation is that they return to the real aim of doing finance and that they come to understand two things. First, that the ethic of virtue, of Aristotelian origin, is 'superior' to the utilitarian ethic if the aim one intends to pursue is the moral and material progress of society.<sup>11</sup> Secondly, the time has come to replace the canons of *scientific management*, now obsolete because they were suited to a model of industrial production which is no longer acceptable, with those of *humanistic management*, whose central element is the human person and no longer the human resource. The post-modern society cannot tolerate that one continues to speak of 'human resources' by the same standard as one speaks of financial and natural resources (Donati 2010).

For government authorities, this crisis also raises two fundamental points. In the first place, that the sacrosanct criticism of the 'interventionist State' is in no way to be extended to the central role of the 'regulatory State'. Secondly, that the public authorities gathered at different levels of government must allow, even encourage, the birth and strengthening of a pluralist financial market, that is a market in which diverse agents can work in conditions of objective parity as regards the specific end they attribute to their activity. I am thinking of the local banks – not to be confused with the local branches of multinational banks – cooperative credit unions, ethical banks, and various ethical funds. These are entities which

<sup>11</sup> See J. McDowell (1978) for a clear exposition of the ethics of virtue applied to economics.

not only propose no creative finance at their own counters, but above all fulfil a complementary and balancing role, with respect to speculative financial agents. To that end, it should be remembered that ethical funds have come out of the crisis very well: neither clients fleeing nor falls in returns have been registered. The European market of ethical funds reached 2700 billion Euros, with a 102% increase in two years. If in recent decades government authorities had removed the many fetters which still burden those who practice this alternative finance, today's crisis would not have had the devastating impact that we are now experiencing.

One example for all. Consider the rules of the Basel II Accord – fruit of the agreement between the public authorities of the OECD countries – concerning the evaluation of the risk for firms asking for credit. If one closely analyses the models which try to measure the firm's probability of insolvency, one discovers that the parameters used for this – *TSR* (*total shareholder return*); *ROE* (*return on equity*) and others which by their nature are focused on short-term objectives – constitute suitable indicators if applied to large capitalist-type corporations, but are not so valid when one is applying them to cooperative enterprises or small and medium-size businesses which work in well-defined territories. It is therefore clear that the criteria of Basel II are not neutral, given that they discriminate between different business types, with the result that non-commercial banks and local banks will see their activities interfered with burdens which do not fall on the shoulders of the large banking groups. An authentically liberal institutional setup cannot tolerate discrimination of this kind.

What has the current crisis got to communicate to financial theory and economists in general? A dual lesson. Firstly, the more sophisticated the analytical tools (mathematics and econometrics) used, the higher must be the awareness of the dangers inherent in the practical use of the products of the new techno-finance. It's this irresponsible lack of intellectual humility that has led not a few mainstream economists, including prestigious Nobel laureates, to look with superciliousness at authors such as J.M. Keynes and Hyman Minsky and to consider outdated teachers of the calibre of John Hicks or James Tobin (both Nobel laureates), scholars in whose works a large part of the consequences that we are now registering were already prefigured.<sup>12</sup> Humility would have permitted drawing lessons from

<sup>12</sup> I will always remember the metaphorical image of Hicks when, still in the early 1970s, he insisted on the need from time to time to put grains of sand into the financial gears, to slow the engine down – an idea that was later translated into the proposal known as the 'Tobin tax'.

a notable historic precedent, that of the illustrious American economist Irving Fisher, so talented from a mathematical point of view (Gibbs, the great thermodynamic physicist was one of his mentors) but so catastrophic a speculator on the stock exchange. In autumn 1929 he publicly stated that share prices had reached maximum stability and Wall Street would never face a collapse. So it was that, working on the basis of the theoretical model that he himself had drawn up, Fisher lost not just his reputation as an economist but the whole of his family wealth.

What is it that lies at the basis of a certain intellectual arrogance still quite common in certain academic circles? Inability to understand, the distinction between rationality and reasonableness. An economic argument can be very rational, mathematically irreprehensible, but if its premises, i.e. its assumptions, are not reasonable, then it will be of little help; it can even lead to disasters. The famous philosopher of science George von Wright wrote in 1987: 'Judgements of reasonableness are directed towards value; they are concerned...with what is good or evil for the human person. What is reasonable is without doubt also rational, but what is merely rational is not always reasonable'. Reasonableness, in fact, is rationality which renders reason reason of and for man. As such, it is an expression of wisdom and not just of intellectual ability. A concrete example of wisdom is to learn – as economic history suggests – that the solution designed to cope with the problems of the last crisis does not prevent the next. The lack of reasonableness among a vast majority of economists seems to reflect a persistent bias in economics towards an idealised account of human behaviour; what J. Schumpeter called 'The Ricardian Vice' of excessive abstraction. In a mechanical world of interacting robots there is no room for being reasonable: rationality is more than enough (Archer 2010).

The second great lesson from the crisis to reach economics is that of speeding things up in order to overcome the so-called conventional wisdom, by which *all* the economic agents would be determined to action by an egocentric motivation. Today we know that such an assumption is actually false: it is certainly true that, depending on the contexts and historical periods, there is a more or less high percentage of people whose sole objective is the pursuit of self-interest, but this frame of mind does not describe the whole universe of the economic agents. And yet, the models of financial theory continue to postulate that the agents are all *homines oeconomici*. As brilliantly shown in Akerlof and Shiller (2009), no more than one fourth of relevant economic actions can be explained by the instrumental rationality postulate. The rest is guided by animal spirits. The consequence of such a

theoretical bias is before our very eyes: from those models come directives for action which are 'sold' to the banking and financial sector. In turn, the directors leading the dance in that sector strive, with great technical-communicative ability, to transform those directives into precise products which then get suggested or advised – so to speak – to the vast audience of individuals or collective investors. Some of these are taken with the 'hunger for money', but many others are induced into choices that they would not have made in the presence of an effective plurality of offers. The point is that the mathematical-financial models do not suggest just lines of behaviour; they change people's mindset, as the results of the most recent neuroscience experimental research confirm *ad abundantiam*. This is to recollect that financial decisions are never simply a matter of technical knowledge, experience or recourse to a process, but are ultimately conditioned by the personal attributes that determine human character, including dispositions and the capacity for right judgement.

Finally, what is the warning the crisis sends to the subjects of civil society bearers of culture? We think of initiatives such as: deleveraging of banks; guaranteeing deposit accounts; sanctioning administrators; take decisive steps towards a new architecture of the world financial system; take concrete measures to avoid the risk that the USA credit card crisis is added to the on-going crisis (Diamond and Rajan 2009). All of this is useful and should be urgently done, but it is not enough, because in a striking manner this crisis has broken up that specific component of social capital which is generalized trust. Since a long time we have known that in order to work a market economy can do without many things, but not trust, because the market is a contractual economy and without mutual trust no contract can be sealed. (Dasgupta 2010). After all, even the CDSs and hedge funds – created precisely to provide guarantees – solicit contracts, although of a particular type. Never forget that the market is a consumer, not a producer of trust, even if it is true that well-designed commercial institutions encourage the spread and enlargement of relationships of trust. A rough but eloquent indication of the lack of trust comes to us from the recognition that, in the inter-bank market, even the banks which have excessive liquidity have stopped today granting loans to other banks, preferring to buy State bonds that are certainly less profitable.

The above brings me to a more general consideration. I do believe time has come to evaluate the robustness of the ethical matrix underneath the economic discourse. So far, this matrix has been the ethics of rules (utilitarian or contractualist) found in a legal system. I am not suggesting that

an ethics of rules and an ethics of virtues are alternatives, as some have claimed (Portes 1977). It seems to me that what must be understood, however, is that it is a virtue-based ethics that endows an ethics of rules with its moral context; not viceversa (Toso 2010). This is so since while the virtues comprise the primary moral categories, rules provide only an analytical classification of moral behaviour. In fact, virtue ethics is grounded not in an act, *per se*, but in a person's character; i.e. the personal behavioural traits exhibited in relationships rather than simply in principles. Virtue ethics seeks an ethics of excellence rather than a mere ethics of effectiveness (McIntyre 1990).

##### 5. INSTEAD OF A CONCLUSION

The task of tying again the 'ropes' between all those who work in the market and which this crisis has clumsily snapped falls to civil society.<sup>13</sup> But where would one start in trying to carry on such a task? From the re-focusing of both the economic discourse and the new institutional setting on the category of the common good. Once a major part of cultural debate, this category has up to now been systematically confused – sadly even by experts – with that of total or collective good. Nothing could be more misleading and therefore noxious. That today the notion of the common good, in the wake of the events that one has tried to interpret here, may experience a re-awakening of renewed interest is something confirmed to us by a variety of signs and which leads us to hope.

*Caritas in Veritate* insists with particular force on distinguishing *common* good (which derives from virtue ethics) from *total* good (which derives from utilitarian ethics). A metaphor may serve to clarify the distinction between these two types of good. Whereas the concept of total good can be presented as a sum total whose components represent the good of each individual (or group), the common good is more like a product in which each factor stands for the good of some individual (or group). The meaning of the metaphor is intuitive. The total of an addition remains positive even if some of its entries cancel one another out. Indeed, if the objective is the maximization of the total good, it may be convenient to nullify the good

<sup>13</sup> Trust, from the Latin *fides*, means literally 'cord', as Antonio Genovesi in his 1765 *Lezioni di economia civile* clearly demonstrated.

(or welfare) of some, if the gains of others more than offset the losses of former. In a multiplication, this is clearly not possible because even if only one entry is zero, so is the result of the product. One should never forget that the choice between the common and the total good is an ethical one, not a choice that can be made on the ground of efficiency. In other words such a choice pertains to the province of practical reason and not to the province of technical reason.

Albert Camus wrote in *Nuptials*: 'If there is a sin against life, it consists perhaps not so much in despairing from life as in hoping for another life, and in eluding the implacable grandeur of this life'. Camus was not a believer, but he teaches us a true fact: we should not sin against present life by discrediting it or humiliating it. We should not move the axis of our faith so much as to make the present insignificant: this way we would be sinning against Incarnation. This is an old option which comes from the Church Fathers, who used to call Incarnation *Sacrum Commercium* in order to underline the relation of deep reciprocity between the human and the divine, and, above all, in order to highlight that the Christian God is a God of men who live in history and a God who takes an interest in and is even moved by the human condition. To love existence, therefore, is an act of faith and not only of personal satisfaction. Such love opens us to hope, which not only has an effect in the future, but also in the present: because it is necessary to know that our deeds have not only an end but also a meaning and value here and now.

The 15th century was the century of the first humanism, a typically European movement. The 21st century strongly expresses the need to develop a new humanism. Back then, the transition from feudalism to the modern age was the decisive factor in this direction. Today, a radical change from industrial to post-industrial society or from the modern age to the post-modern age is what suggests the urgency of a new humanism. Globalization, the financialization of the economy, the new technologies, the migratory issue, the increase in social inequalities, identity conflicts, the environmental issue and international debt are only a few of the words that tell us about 'civilization and its discontents', quoting a famous essay by Sigmund Freud. Merely updating old categories of thought or simply turning to collective decision techniques – even the most advanced ones – are not enough in order to face the great contemporary challenges. It is necessary to be brave and walk along new paths: this is the passionate invitation of *Caritas in Veritate*, which is reminiscent of Thomas More's dictum: 'If you cannot completely eradicate wrong ideas or deal with inveterate

vices as effectively as you would wish, that is no reason for turning back. You cannot abandon the ship just because the winds are difficult to control' (*Utopia*, 1529; paraphrase).

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## 'GOOD LIFE' IN ECONOMY AND FINANCE OR THE REBIRTH OF THE ETHICS OF VIRTUES

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Past and current forms of auto-nomination and absolutization of finance in respect to real economy, as well as the trends towards a quick and sometimes very short-term economy, are often expressions of attitudes and behaviours driven by a utilitarian mentality and individualistic cultures, as well as of a reduction to its technological dimension.<sup>1</sup> At the root of such unscrupulous behaviours, which in the relationship between financial institutions, the economic world and the civil society constructed on falsehood in communication and reporting system (cf. CIV n. 65), lies the lack of a clear social responsibility as well as a certain blindness, whether intentional or not, with respect to the truth regarding these areas and their purpose, which should be subordinated to the good of people and society.

The proposal of an economy and of a finance filled with *universal brotherhood* and oriented to the common good (cf. CIV n. 36 and n. 38) calls for a 'good life', that is a *virtuous* life, animated by 'charity in truth'. As required by the CIV this presupposes the existence of a human *télos*, which in turn requires, from every person, the *capacity* to know and love the truth, the good and God, and the participation in the common search of these values and of 'what is just' (cf. CIV n. 59 and n. 73).

When in a society sceptical or relativistic views regarding the knowledge of truth prevail, and also ethical concepts are held as the only basis for an *overlapping consensus* or public dialogue – as it can be found in John Rawls' *neo-contractualism* theories or in the dialogical theories based on the principle of impartiality or in the *third person ethics* – the basis for a 'good life' in economy and in finance is lacking.

<sup>1</sup> Cf BENEDICT XVI, *Caritas in Veritate* (=CIV), Libreria Editrice Vaticana, Città del Vaticano 2009, n. 32.

Specifically with reference to these epistemological and cultural assumptions that are evidenced from the point of view of the 'impartial observer', in order to overcome the macroscopic contradictions of that kind of utilitarianism and individualism, the CIV suggests the recovery of a well thought out and established moral conduct based on the *person viewed as a subject, as a free and responsible agent*, living and acting as a being which is *structurally open to God*. In other words, it calls for the abandonment of ethical projects thought out and configured *etsi Deus non daretur*.

The moral obligation and social responsibility, as well as new rules for economy and finance, do not, ultimately and interiorly, involve the single or communitarian subjects, *unless* they are rooted in the person itself and, more specifically, in his/her natural inclination to truth, to goodness and to God which consolidates itself in *the natural moral law*, that is the universal law (cf. CIV n. 59).

Then, in view of the practicing of a solid and persevering 'good life' in/of economy and in/of finance and its globalization or universalization, Benedict XVI deems it of paramount importance to work in depth, primarily on the *epistemological, cultural level* and on the *formation* of consciences. The restoration of a *global reason*, i.e. a reason that functions in its total capacity, according to the multiple degrees of its exercise, is preliminary to this work, as taught by great philosophers of the past and the present, among whom at least Aristotle, Thomas Aquinas, Jacques Maritain, John Finnis, Joseph Martin Rhonheimer and Giuseppe Abbà are to be mentioned.

Only through a reason that is not maimed, but active on the theological, metaphysical and practical levels, it is possible for the moral subjects to rediscover the significance of natural moral law, to possess that *humanistic cultural synthesis*, that *hierarchy of goods*, as well as those *spiritual energies* that permit a virtuous existence in the economic and financial areas. In fact, as already stated, the moral conduct rests ultimately upon the *innate ability* of persons – irrespective of whatever race, culture or religion they belong to – to have *access to truth, goodness and God*. Thanks to such universal capacity, the first moral principles are perceived – 'do good and avoid evil'; 'do not do unto others what you do not want to be done to yourself' – and man is enabled to attain that knowledge, though imperfect and dim, of the Supreme Truth and the Supreme Good which is God.

Thanks to this attainment, each person can know the human *télos* and can structure it as a *unified whole* of goods *hierarchically arranged*, corresponding to the harmonious whole which is the real and concrete person. It is in force of the openness of the human spirit – made up of emotion,

affection, intuition, intelligence, will, freedom and responsibility – and of its *dynamism towards God*, in a ceaseless self-transcendence, that the human person is able to recognize the intrinsic aim of economy and finance within an ethical whole, constituted by the multiple goals that substantiate the *human fulfilment in God*. It is precisely within such a moral womb, where the unity of *meaning* and *measure* is given by God himself, that economy and finance realize both their irreducible specificity as well as the limit of their ethical valence: they are not the whole moral nor are they independent from the moral regulation of life. Their utility and function are real, but they are not the most important good and are not detached from other personal ethical goals, which belong to a higher grade.

In this multiplex context, economy and finance should be pursued as a useful good, but not as absolute ends. In the overall good of persons and of peoples, they are to be subordinated to other goods and ultimately to the achievement of the Supreme Good and of the Supreme Truth.

The ‘good life’ in these operative areas is supported by behaviour and lifestyles which, while they pursue with determination and perseverance the proper goals of economy and finance, link them up with those of other human activities and harmonize them with the ultimate end, i.e. the spiritual union of man with God, by subordinating them to it. Without God it is impossible to imagine ‘forms of economic activities’ marked by fraternity and ‘quotas of gratuitousness and communion’ (CIV n. 39).

Such subordination does not bring about an under-dimensioning of the utility of economy and finance nor even an impoverishment of the corresponding ethics and professionalism. Far from it. The experience of recent times has rather shown that absolutization of finance as an idol, has brought about the de-structuring of ethics and consequently its failure. Without God it is very difficult to abide by a just and virtuous moral conduct. Good economy and good finance imply their being pursued as useful means to achieve other human goods, which are more important. When they are pursued in an orderly manner towards the true and complete human good, they are better safeguarded in their autonomy and in their purpose within their area of instrumental goods without pretending to hoist them as the ultimate end of man.

Moreover, experience shows again that, because of human frailty and selfishness, economy and finance do not always present themselves as positive realities at the service of common good. It is no coincidence, then, that in view of their virtuosity, the CIV appeals to the indispensable *redemptive action* of Christ and to the *public role* of Christian religion. According to

Benedict XVI, they realize themselves as 'virtuous' acts, if animated by an *intelligent love* and lived constantly, through a proper process of education, according to the 'charity in truth', the life that Christ has gained for mankind through his incarnation, death and resurrection (cf. CIV n. 1).

The vision and interpretation of economy and finance within the plurality of goals that belong to the human *télos* of the family of peoples, induces to subordinate their exercise not only to common good (cf. CIV n. 36) but also to *social justice* (cf. CIV n. 35), which safeguards it in as much as it is connected to it. This is required above all by a globalization which, when not properly controlled, creates disparities in the participation in the global revenue, inequalities that tend to erode social cohesion and 'social capital' (cf. CIV n. 32), unjust exploitations and divisions in the human family (cf. CIV n. 33).

# THE RECESSION AND THE U.S. FAMILY

KEVIN RYAN

The financial crisis of 2007-2010 has been called by leading economists the worst economic recession in seven decades. This global financial collapse, which began with the U.S. housing bubble, has rippled through central banks, stock markets across the globe and caused the loss of an estimated fifteen trillion dollars of consumer wealth. The impact of this crisis has been felt from New York's Wall Street to Soweto's side streets. According to the World Health Organization [2009], increases in the cost of food and fuel have caused more than 100 million people to have fallen back into poverty.

## GLOBAL EFFECTS ON PERSONS AND FAMILIES

Reports from around the world reflect that the current global recession is causing significant threat to family stability. Many families are under extra pressure in a time when people are in special need of a stable, intact home life. As an example, a recent United Kingdom report [Callan, 2009] on the recession effects on the family found:

- Falling house prices are an additional source of pressure on marriages. Researchers from the University of Essex looking across the last 14 years found that decreases in house price affect family stability, to such a degree that 'for every unexpected 10% fall in house prices, an extra 5% of couples will split up'.
- Over 50% judged life to be tougher now than 20 years ago. A key factor was the infrequent contact with wider extended family.
- Demand for counseling is on the rise...At the same time, people's ability to contribute to the costs of these services has been reduced, putting pressure on such agencies.

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### EFFECTS ON CHILDREN'S HEALTH AND EDUCATION

In an international study of the effects of the recession on the health and education of children, surprisingly the researchers found that 'in richer countries', like the United States, child health and education outcomes are counter-cyclical: they improve during recessions. In poorer countries, mostly in Africa and low-income Asia, the outcomes are procyclical: infant mortality rises and school enrollment and nutrition fall during recessions. In the middle-income countries of Latin America, the picture is more nuanced: health outcomes are generally procyclical and education outcomes counter-cyclical [Ferreira and Shady, 2010].

The effects on health, on the other hand, in countries such as the United States (USA) and Western Europe, are positive and mortality rates fall. The suggested explanation is that during recessions there is a decrease in the use of alcohol and tobacco. Children around the world are the consistent victims of economic crisis [World Health Organization, 2009].

### MARRIAGE AND FAMILY DATA IN PERSPECTIVE

While there can be little doubt that losing employment, retirement savings, or having to take a second job to make ends meet cause stresses on a marriage, studies and reports give only a sketchy picture of the nature of these disruptions. In a recent U.S. study, 58% of the respondents reported experiencing some form of stress [Rasmussen, 2010]. In another survey, conducted by a U.S. lawyers group, found that 37% of people between 18 and 34 said they were postponing marriage, divorce, or children [econ4u.org/blog, 2009].

A more serious threat to the U.S. family and the institution of marriage is the disproportionate impact on males. Because the economic downturn has hit the building and manufacturing sectors so severely, one consequence is that men account for 75% of the job loss. Different from earlier recessionary periods, labor economist, such as Brookings' Gary Burtless, are predicting the bulk of these laid off men, because of outsourcing and automation, will be forced to start over in a different industry if they are to regain employment [Burtless, 2010]. The implications of this disruption for U.S. male workers and their families, and possibly throughout the world, could be profound. Laid off men get into trouble. They spend less time with family and kin and more with casual friends. They spend more time in bars

and less time in church. Their problem quickly becomes the problem of their families and those around them [Peck, 2010].

While these studies and current data call our attention to immediate trends and worrisome disruptions in U.S. families, they are slight variations on an institution which in recent decades has undergone larger and more serious disorders. In the last half century, age-old religiously affirmed sexual mores and established prohibitions have been brushed aside. In the U.S.A. and perhaps in Europe understandings of 'marriage' and 'family' have undergone radical changes. Key to these changes has been the development and wide availability of the oral contraception or 'the Pill'. It is widely acknowledged that practices that once brought severe civic penalties are now promoted by government policymakers and affirmed by well-regarded scholars.

While it may be convenient to blame U.S. family stress on mistakes made by Wall Street financiers, the real culprits behind what ails the family may still be undiscovered and they may, indeed, have been in our peripheral vision for a while. In an article entitled, 'The Vindication of *Humanae Vitae*', Mary Eberstadt reports on the devastating impact of what is called the 'sexual revolution' [*First Things*, Aug/Sept, 2008]. *Humanae Vitae* warned that four trends would result from the widespread use of artificial contraception: a general lowering of moral standards throughout society; a rise in infidelity; a lessening of respect for women by men; and the coercive use of reproductive technologies by governments [*Humanae Vitae*, 1968].

Four decades after its publication, not only have the encyclical's signature predictions been ratified with empirical force, but they have been ratified by social scientists and scholars with no interest whatever in the Church's teaching, and by many who are proud public adversaries of the Church. As sociologist W. Bradford Wilcox emphasized in a 2005 essay: 'The leading scholars who have tackled these topics are not Christians, and most of them are not political or social conservatives. They are, rather, honest social scientists willing to follow the data wherever it may lead' [Wilcox, 2005].

#### THE LOWERING OF MORAL STANDARDS

The arrival of the Pill in the 1960s not only allowed females to control their own pregnancies, or lack thereof, but it unleashed a widespread change in human behavior. The consequences of fornication with few discernible costs have been global, leaving few unaffected in some way by divorce, single parenthood, abortion, cohabitation, extensive social diseases, widespread pornography, and open homosexuality.

Reporting on the impact of artificial birth control, Nobel laureate George Akerlof explained how, contrary to common prediction, especially prediction by those in and out of the Church who wanted the teaching on birth control changed, it has affected the human community. In his 1996 *Quarterly Journal of Economics* article, Akerlof asserted the much vaunted use of artificial birth control has in reality led to an increase in both illegitimacy and abortion.

#### THE RISE IN INFIDELITY

Since World War Two, divorce around the world, but particularly in the First World, has exploded. Rates, also, vary enormously. As of three years ago, the divorce rate in India was 1.1% and in the United States the rate was 54.8% [Nita, 2007]. While the current recession has cut somewhat into the frequency of divorce, for two decades now social scientists have been reporting on its effects. Akerlof found a significant connection between the diminishment of marriage, on the one hand, and the rise in poverty and social pathology, on the other. Further, he discovered what in his view are both direct consequences of the contraceptive revolution: the empirical connections between the decrease in marriage and in married fatherhood for men and the simultaneous increase in behaviors to which single men appear more prone: substance abuse, incarceration, and arrests, to name just three [Akerlof, 1996].

On the impact of the new sexual mores on family structure, Eberstadt's research led her to state:

Just about everyone else in possession of the evidence acknowledges that the sexual revolution has weakened family ties, and that family ties (the presence of a biologically related mother and father in the home) have turned out to be important indicators of child well-being – and more, that the broken home is not just a problem for individuals but also for society. Some scholars, moreover, further link these problems to the contraceptive revolution itself [2008].

#### THE LESSENING OF RESPECT FOR WOMEN BY MEN

While figures on the physical abuse of women by men are difficult to come by and measures of attitude shifts are elusive, one glaring sign of

male disrespect for women in the U.S.A. is the ubiquity of pornography. While we are surrounded at every turn by 'soft-core' pornography, from magazines and billboards to television commercials, the widespread availability of and the addiction to hard-core pornography is relatively recent. Technological changes from high-powered computing, expanded cable television, and the development of the Internet have made pornographic videos and images easily accessible to almost every home or cell phone around the globe. This graphic exploitation of women and young girls, once of province of a cultish minority, is beyond shocking and represents a new and pernicious form of violence against women.

Recently, Princeton University's Witherspoon Institute, under the leadership of Robert P. George, conducted studies and convened a conference on the Social Costs of Pornography. Among the alarming findings are 'estimates that as much as 35% of all content on the Internet is pornographic; that two-thirds of U.S. college-age men view pornography with some regularity; that a majority of U.S. high school students visit pornographic websites, some trading obscene images of themselves electronically' [James Stoner, 2009]. Much of the conference's focus was on the negative effects of repeated exposure to hard core pornography on brain chemistry with evidence mounting that the addictive connection of sex and violence – pleasure and pain – has a long term effect on the male brain. In addition, sociologists report that 'ready access to pornography on computers has brought the social effects of pornography in from the margins of society to the heart of married life, with predictably devastating effects' [Stoner].

Archbishop Charles J. Chaput of Denver, speaking in 1998 on the thirtieth anniversary of *Humanae Vitae*, may well have been thinking of pornography when he observed, 'Contraception has released males – to a historically unprecedented degree – from responsibility for their sexual aggression'.

#### THE COERCIVE USE OF REPRODUCTIVE TECHNOLOGIES BY GOVERNMENTS

In 1968, at the same time *Humanae Vitae* was published, many in the social science community captured the public's attention with concern for the coming population explosion, as it was called. That same year, 1968, saw the publication in the U.S. of Stanford University's Paul Ehrlich's *Population Bomb*. One of the most popular scientific treatises ever published, the book convinced many within and without the Church that the moral high ground was to be found in the widespread promotion of contracep-

tion. From families to nation states, policies were put into effect to curb the size of families. So successful has been the combination of the population scare and contraception solution that currently in the U.S., 90% of Catholic are said to be in favor of artificial birth control [Harris Interactive, 2005].

The tragic irony is that the population bomb has largely sizzled and forty years later demographers are ringing the alarm bells over the low, non-replacement birth rates in many First World countries, such as Japan, Russia, Italy, Spain and Ireland.

While some countries responded to the population scare with educational campaigns and making abortions legal and free, some, notably China and India, used the full power of the state to control their populations. China's brutal one-child policy, coupled with parents' propensity to sex-select in favor of males has had a devastating impact on the social fabric of China itself. According to a recent reports from the Chinese Academy of Social Science [CASS], in fourteen provinces the male-to-female birth rate is 120 to 100 and above in favor of males [*The Economist*, 2010].

The predicted governmental power, promotion, and implementation of birth control technologies are clearly among the great disgraces of the Twentieth Century.

While our current recession has caused disruptions and often suffering in families across the world, these pale before the effects of the Pill. In the U.S. it is the rare family which has not been wounded by the tumbling effects stemming from the widespread use of birth control and the sexual revolution the Pill has spawned.

## ANXIETY

Not all the pain being caused by the current recession lends itself to empirical analysis. One such example is the widespread anxiety induced by the current recession. While it pales before starvation, sickness and the chaos of a breakdown of civil rule, anxiety, nevertheless, has a range of negative psychological and physiological effects. Among them are crippling fear and debilitating worry and stress.

Our current economic downturn, with the loss of jobs and loss of savings, has clearly spread and deepened anxiety. For instance, in the U.S., there is serious pain behind the official reports of 10% unemployment, and 18% unemployment when the discouraged, no-longer-looking-for-work individuals are included. There is real hurt to retirees and those nearing the

end of their employment when they see that their retirement funds has been reduced by a third.

A recent survey in the U.S. found most Americans (58%) say the current state of the U.S. economy has caused more stress in their family [Rasmussen Reports, 2010]. The recession-induced threats to employment or the actual loss of work causes discouragement, personal despair, loss of motivation, lowering of aspirations and abandonment of future plans. Statistical data on unemployment rates, retirement savings, shrinkage of the money supply and housing again do not yield easily to quantification and positivistic analysis. Nor do they capture the full social reality resulting from these recession-induced anxieties. Still some recent research has been illuminating.

In a survey by the American Psychological Association conducted last September, 2009, 80% of the respondents reported that the economy was causing them 'significant stress'. Other research in the U.S. has shown a recent and significant rise in suicide. According to Richard McKeon, the study's project officer, economic stress 'played a central role' in the 25% increase rate of suicide from 2008 to 2009 [McKeon, National Suicide Prevention Lifeline, 2009].

A recent study in the UK speaks more directly to the impact of increased anxiety on families [Callan, 2009]. Samantha Callan's research found three widespread effects of stress brought on by the current recession: fear of financial and debt pressures; fear of, or actual, unemployment; fear of, or actual, loss of housing. Some of the impacts of these fear induced stress are: Increased irritability leading to increased inter-personal conflict; depression, particularly in males.

These changes in individual behavior generally impact directly and negatively on couple relationships and on any children in the family. The Callan report states 'that much of the negative impact of financial stress on the parent-child relationship may not be a direct result of the original stress, but is linked to a mediating effect: disruption of the couple relationship'.

Nevertheless, perhaps in all of the First World but certainly in the U.S. the recessionary situation today is heightening the severity of the anxiety being experienced by the younger segment of the work force, people between the ages of 18 and 40. Increasingly, they are part of a world of work dominated by change and uncertainty. They are part of an economic scene where fresh knowledge and new skills must evolve continually and are increasingly demanded by the realities of the workplace. They are continually bombarded with warnings: 'You need to change! You need to keep up! You aren't prepared enough for the "new thing" that is coming soon'.

One's secure job today can be on the ash heap tomorrow. Today's workers, whether in offices or factories, exist in an employment environment where loyalty between worker and management has been greatly attenuated, and been replaced by with self-interest and self-protection. Once common guarantees of lifetime employment are now rare. Workers early on incorporate the message, 'Face the facts. Basically you are on your own, so be independent. Stay disconnected and ready to move on'.

Martine Brun, a French entrepreneur, recently wrote about the effects of the current economic conditions on young workers:

Unemployment for the young is not only a loss of income. It induces difficulties to project yourself in the future. A period of full employment, allows young workers to negotiate their salary, their conditions of work, to change their job if they find something better elsewhere and finally to build a personal life on a long range. Our contemporary situation is totally different. Working classes are criticized for not taking risks. But potential consequences of moving to another job, or creating one's own company are much more dangerous than they were. There are less opportunities for young people to become executives, to raise their rank in a company. Instead, they see the increasing risk of becoming unemployed and this during their whole career [Brun, 2009].

Recessions, such as our present one, heighten this sense of social impermanence. The young adult who is unable to 'project himself into the future' turns in on himself. He rejects marriage and family in favor of independence and temporary cohabitation. He fails to become part of a community.

#### FINAL CONSIDERATIONS

While in no way understating or discounting the enormous economic evil, pain and suffering caused directly by our Great Recession, there are, perhaps, some upsides to this downside, when the crisis has indirectly served to reconsider the most profound aspects of marriage and human relations. For instance, a study recently released in the U.S. reports that the divorce rate has actually fallen from 17.5 divorces per 1000 married women in 2007 to 16.4 divorce per 1000 women in 2008 [Wilcox, 2010]. One explanation is that couples may be putting off divorce until the economy recovers. On the other hand, difficult economic times appear to have a solidify-

ing effect on many U.S. couples. Couples are forced to surrender some of their individuality and together work through difficulties.

For many couples in the U.S., this recession has meant less discretionary money, fewer expensive vacation trips, but more time with their children and with one another. This forced financial prudent and less materialistic lifestyle means for many greater reliance of family, more volunteering and great empathy for others. Grandparents are being enlisted to replace expensive day-care arrangements, assist financially, often taking in the couple that lost their home in the mortgage crisis.

Family debt is considered corrosive of marriages. However, one of the most dramatic effects of the 2008-2009 financial crisis in the U.S. has been the sharp decline of personal debt. After having expanded yearly for well over a decade in the U.S., to 988 billion dollars, credit card debt has actual shrunk by 90 billion dollars since the crash. This is important since a high level of credit card debt in a marriage is correlated to fighting, lack of time spent together and significantly lower levels of marital happiness [Dew, 2009].

Bradford Wilcox acknowledges the heavy toll of escapist drinking, marital fighting, separation and divorce wrought on many families in the U.S.A. Nevertheless, he summaries the situation thus:

The recession reminds us that marriage is more than an emotional relationship; marriage is also an economic partnership and social safety net. There is nothing like the loss of a job, an imminent foreclosure, or a shrinking 401(k) to gain new appreciation for a wife's job, a husband's commitment to pay down debt, or the in-laws' willingness to help out with childcare or a rent-free place to live [2009].

Commenting on the legislative opportunity offered by the recent recession, a key advisor of the current U.S. president observed that 'No crisis should be allowed to go to waste'. In a larger, more humanly inclusive view, we might observe that our current recessionary situation is an occasion for rethinking fundamental questions, such as what constitutes a good family and a good education. Our crisis, too, gives the Church a new opening to project Catholic social thought and its principles, such as solidarity and subsidiarity. And more importantly, that our deepest human needs will only be touched by Christ's life affirming message.

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# BUSINESS LEADERSHIP *SINE SPECIE AETERNITATIS* IRRESPONSIBILITY IN A GLOBAL SPACE

LUBOMÍR MLČOCH

*Motto: 'The conviction that man is self-sufficient  
and can successfully eliminate the evil present  
in history by his own action alone has  
led him to confuse happiness and salvation  
with immanent forms of material prosperity  
and social action'.*

*Caritas in Veritate, 34*

## 1. BUSINESS LEADERSHIP TO BE LEARNT

Allow me, please, to start with a personal confession and an expression of gratitude. I have no practical experience with business leadership of great corporations – perhaps with the exception of a very special, involuntary, fifteen-year ‘sabbatical’ in a Prague factory during the communist regime. Also, for historical reasons, there is no equivalent to the English word ‘leader’ in the Czech language. Two similar Czech words ‘vůdce’ and ‘vedoucí’ have negative connotations: the first one calls to mind the German word ‘Führer’ from the period of the Nazi Protectorate and the second indicated a leading party cadre in the command economy for 40 years. Hence, the English term ‘leader’ is now used in the Czech milieu. Readers are asked to note these reservations.

For these reasons it was important for us to learn a proper meaning of business leadership after the fall of communism. For six years, 1997-2002, I had an exceptional opportunity to participate in ‘The Leadership Forum Prague’ project. The first U.S. Catholic university Georgetown/Washington, D.C. offered to the historically first university in Central Europe – Charles University – help in teaching, building and fostering business ethics for emerging markets. I am grateful to God that at that opportunity I met my late friend Milan (Mike) Miskovsky of Woodstock Theological Centre at Georgetown. Mike Miskovsky – who died last year – had a great spiritual charisma

and a gift to teach what business leadership *sub specie aeternitatis* meant – just by ‘doing annual conferences’ – about leadership, about the role of corporate governance and investor expectations in a global marketplace. In 2001, apart from the ‘Success Together’ conference, the Leadership Forum organized a lecture by Professor Stiglitz. At the time Charles University gave him an honorary doctorate, thus anticipating his Nobel Prize, which he received a few months later. The lecture by Professor Stiglitz had a prophetic air, he pointed to the role of trust as a pre-condition for market transactions. The last Leadership Forum Conference took place in 2002. It dealt with the transformation of the Czech banking sector and attracted even the attention of Czech political leaders, including the Minister of Finance...

For these six years Mike and myself shared confidence and a common belief that America was a model and a competent teacher of business leadership. Later, as a consequence of a series of scandals, such as ENRON, this trust was gradually eroded. It happened not only on our side: a crisis of self-confidence developed on the other side as well. The former Governor of the NYSE, Rohatyn, said at that time that these abuses had shaken public faith in the fairness of the American System. I remember my last talk with Mike: although at all previous times he had encouraged me by repeating that ‘positive thinking was needed’, this time he felt that a global crisis was approaching, and that it was a moral crisis – a crisis which included also the Church – that would cause the financial crisis. During his illness, Mike suffered twice, physically and also from distress – from feelings of futility of his professional life effort. At least for me – and I believe also for many of the Leadership forum participants – Mike’s effort was not futile, if for nothing other than a glimpse of eternity that Mike had passed to us. But Milan Miskovsky’s fidelity to the Catholic social doctrine and his obedience to the Church’s Magisterium did not have any spectacular character; Milan was a humble man.

## 2. THE CHURCH HAS ENTERED THE ECONOMY IN TWO DIFFERENT WAYS

I discovered Catholic social teaching for myself at the Fribourg conference ‘Éthique, économie et développement – l’enseignement des évêques des cinq continents’ (1993). Professor Émile Poulat (France) characterised a novelty of this Fribourg conference with his proposition: the Church has entered the economy. Nevertheless sixteen years later, Benedict XVI had to confess that, ‘After the collapse of the economic and political system of the

Communist countries of Eastern Europe and the end of the so-called opposing blocs, a complete reexamination of development was needed...a comprehensive new plan for development...also in the West and in those parts of the world that were in the process of evolving. This has been achieved only in part...' (*Caritas in Veritate*, 23). A series of questions arises here: as regards this challenge of a new plan for development, why did the Church succeed only partially? Why were neither *Sollicitudo Rei Socialis* nor *Centesimus Annus* by John Paul II enough for this task? What share of this only partial success can we attribute to faults and failures of economics? Does economic theory – as one of the sciences about 'earthly realities' – with its legitimate autonomy – bear its own responsibility (*Gaudium et Spes*, 36)? Why is it that only 'the current crisis obliges us to re-plan our journey'? (Benedict XVI in *Caritas in Veritate*, 21).

Émile Poulat had in mind not only new reflections on economic issues in encyclical letters, but also new initiatives for the application of Catholic social teaching at the level of different countries, regions and continents. And the first bishops that started this process and entered the economy were the U.S. bishops in their letter 'Economic Justice for All' (1986). Consequently, in order to understand why the Church, when entering the economy (and economics) stopped half way, we ought to return to the U.S. before 'Economic Justice for All'.

During the preparation of this pastoral letter of the U.S. bishops, a 'Lay commission on Catholic social teaching' published another document entitled 'Toward the Future, A Lay Letter', New York (1984). This lay letter had a greater ambition than applying universal Catholic social doctrine to the U.S. economy. Leading persons would rather like to use the U.S. historical experience to re-formulate the universal teaching of the Church. This lay letter was dedicated to Pope John Paul II and to 'our bishops', nevertheless there was an inner tension between these two perspectives ('good intentions are not enough') o.c., p. X, 'markets do not bend to pious wishes' (o.c., 44). To define one perspective as 'lay' and another one as 'bishop' was probably misleading. Nevertheless, already three years before, in *The Corporation. A Theological Inquiry* (eds. Novak, M. and Cooper, J.W. 1981), a split between the 'clergy' and 'lay people' was even clearer. The perspective of the world, as seen through God's eyes, and the 'Theology of Earthly Realities' (Gustav Thils: 'Théologie des réalités terrestres') have been accepted and newly formulated by the Vatican II *Gaudium et Spes*. John Paul II again stressed this feature of the Catholic social doctrine: 'an ideal orientation' as 'indispensable', i.e. that cannot be dispensed with (CA, 43). Patrick de Laubier (1994)

says in this connection: ‘...la doctrine sociale de l’Église assure une régulation, une orientation idéale basé sur la loi naturelle et les Béatitudes...Les Béatitudes exaltent ce que le monde n’apprécie guère: la pauvreté, la douceur, la pureté, etc.; ce sont pourtant des éléments essentiels qui humanisent une collectivité...contrairement à l’utopie qui est une idée humaine sans chance de réalisation, l’espérance chrétienne d’une civilisation de l’amour repose sur l’Esprit saint qui tout en respectant les libertés humaines qui doivent coopérer à la réalisation du dessein de Dieu’ (o.c., pp. 156-157).

The normative perspective of the Catholic social doctrine includes inherently ‘ought’. On the other hand, M. Novak stresses another perspective, that of ‘is’: ‘We were taught (at Harvard) the importance of the descriptive and warned against the normative’ (Novak, M. – Cooper, J.W. 1981, p. 227). In the theology of earthly realities, it is just this normative perspective *sub specie aeternitatis* that refers to God’s view; without that the Catholic social doctrine is endangered by ‘une sorte de rationalisme retenant exclusivement ce qui est humainement envisageable, sans se préoccuper de la fin dernière surnaturelle...’ (de Laubier, o.c., p. 159). On the other side (A Lay Letter, p. 3) a hope of possible complementarity has been expressed. After complaining that ‘the many contributions of the American experiment to Catholic social thought have been given too little recognition’, there is a desire to learn from each other. To meet half way is surely needed, nevertheless a complementarity between ‘is’ and ‘ought’ has to be clearly defined; otherwise the Catholic social doctrine could result in an utterly confusing and misleading message.

### 3. THE PERSPECTIVE OF THE ‘PROSPERITY GOSPEL’ IS DIFFERENT FROM THAT OF THE GOSPEL

Reginald H. Jones in his contribution about the transnational enterprise and world economic development (in Novak, M. – Cooper, J.W. eds, pp. 129-141, and a discussion that follows) raised the question ‘Is Business Satanic?’ and answered himself that it is not. Another subtitle of his paper says ‘People Want Material Progress’. And – under the subsequent subtitle – Jones expressed one self-evident truth: ‘A church cannot long survive, if its people follow other leaders’... (o.c., p. 140). While Jones was convinced (thirty years ago) that the reason for a split between the leaders and the people is ‘left-wing activism’ by some Church leaders, I would like to offer a rather different explanation and recall the ‘sign of our times’.

Allow me to use James Twitchell's 'temptations' from his 'triumph of American materialism': 'What makes Christian materialism so powerful a precursor to commercial culture is that in both Catholic and Protestant teaching it is so fiercely denigrated' (Twitchell, J. 1999, p. 61). It is *nihil novi sub sole* that 'people want material progress' (Jones, R.H., in Novak, M. – Cooper, J.W. 1981, p. 138) – Moses as a spiritual leader had to face the Golden Calf temptation of his people.

The distinction of the two perspectives – sharply expressed in this well-known story of the Old Testament – is perhaps even more apparent in the Beatitudes of the New Testament. Nevertheless – in our times – there are interpretations confusing 'rules' of God's Kingdom and rules of 'making money'. After Vatican II, the dispute focused on the interpretation of 'the autonomy of the temporal order'. Mark Lowery in his warning against 'coercive Utopians' – that we in post-communist countries have only to confirm – goes further and warns against ideals as such (Lowery, M. 2005). Lowery's note 8 (o.c., p. 451) characteristically quotes from Naipaul's *Magic Seeds*: 'It is wrong to have an ideal view of the world. That's where the mischief starts'. A correct criticism of the liberationists could fuse with a 'libertarian' position. Catholic social teaching has to avoid both Scylla and Charybdis. The historical experience of post-communist countries is a warning: after the fall of 'coercive Utopian' power they succumbed to the temptations of 'seducer Utopians'.

Jones' thesis that 'the poor but happy society doesn't exist anywhere' is not true (Jones, R.H. *ibid.*). 'Happiness and economics' links have been a subject of scientific research for decades, and Robert Easterlin's paradox is known – if we do not want to restrict ourselves just to the Franciscan communities (Short, W.J. 1999). The journal *Science of Happiness* recently celebrated 10 years of existence, and several hundreds of papers – outside the Church – raised doubts about the single-minded link: material abundance equals true happiness.

A famous young man from Assisi had a personal experience of life in abundance. In this key point there is no difference between the 13th century and our times. Raniero Cantalamessa wrote in his *Povert * that the conscience of the Church always rejected a 'Prosperity Gospel' as a clearly misguided idea (Cantalamessa 1996). On the other hand, a 'guru' of consumerism, James Twitchell – in order to support his blasphemic 'prayer' (lead us into Temptation!?) – didn't hesitate to quote a blasphemic 'bonmot' of the founder of the BBC, Lord Reith. Coming after World War II to the U.S., he said: 'What I would like to know is how you Americans can suc-

cessfully worship God and Mammon at the same time?' (Twitchell 1999). This line of argumentation contradicts the words of the Son of God (Lk 16). Jesus' stern warning against temptations in the following chapter (Lk 17) also makes a clear distinction between a 'positive' perspective and a normative one. We Christians would remember Mahatma Gandhi's criticism of our modern Occidental or European civilisation as purely materialistic, adoring Mammon, clearly not adhering to the teaching of Jesus (see Herbert Jean, *Ce que Gandhi a vraiment dit*, pp. 138-139).

The topic of my paper requires me to go further and to try to specify what the Prosperity Gospel means. I would claim that it is a doctrine of another young man from the famous parable of our Lord about the Rich Young Man (Mt 19, Mk 10, 17-31, Lk 18, 18-30). I would dare to say that all of us in the first world – as we are very rich – are 'going away sad' from our Lord. The so-called Judaic-Christian civilisation of our times has become a victim of this confusion between Gospel and Prosperity Gospel, and it may be possible – in a provocative way – to address Blaise Pascal's old anti-Jewish condemnation to all of us. So, we Christians (in the West) became 'peuple cupide, axé sur la concupiscence et l'amour de soi, esclave des biens de la terre...pires que les païens ils demeurent tournés vers les biens terrestres tout en connaissant le vrai Dieu'. Let's put aside a gnostic attitude of Pascal with his segregation from the point of view of 'chrétiens spirituels – vrai chrétiens', nevertheless a warning against a 'drug addiction to consume' leading to a super-development 'oblige us to re-plan our journey', and 'to shape a new vision for the future' (*Caritas in Veritate* 21).

The last lecture given by Cardinal Ratzinger before he was elected Pope (2005) – concerns a crisis of culture in St Benedict's Europe. In Autumn 2006 the European Commission published a consultation paper entitled 'Europe's Social Reality'. The Bureau of European Policy advisers stated, that 'the social well-being of all Europe's citizens should be...at the heart of everything the EU and its Member States do'. The authors realise that 'well-being embraces something more than material living standards that our societies achieved'. The point is that our culture is predominantly materialistic, and the root of the present crisis is in this materialism. St Benedict's Europe observed her patron's maxim *Ora et labora* for centuries and God blessed the European effort with material progress...While by increasing her wealth – and 'catching up' with the U.S. – Europe has lost her willingness to pray (cf. Mlčoch 2009).

#### 4. FROM THE RELIGIOUS FOUNDATIONS OF CAPITALISM TO A ‘CORPORATE AMORALITY DOCTRINE’

What happened to our culture that we lost our faith? Till recently great sociologists have tried to explain the birth of capitalism – a system with historically unprecedented dynamism – from its spiritual roots and a comparison with different world religions. Sombart (1902 and 1922) formulated a hypothesis about the Jewish foundations of economic, trade and financial activities that define ‘moderne Kapitalismus’. Weber (1904-1905 and 1920) came with his famous ‘explanatory variable’ – protestant ethics that was breathing a spirit of capitalism. Michael Novak, with some delay, raised not a competitive but rather a complementary hypothesis about Catholic ethic that esp. in Northern Italian cities also helped the evolution of a giant cosmos of contemporary capitalist market economy. No matter to what extent we can provide empirical tests of these perhaps too idealistic hypotheses, there is a historical fact that capitalism was born within our Euro-American culture with its Judeo-Christian roots. Only later did this genie expand to other continents; so it is our own culture that not only can be proud of the triumphs of capitalism, but also responsible for the global consequences of this evolution.

There is a paradox, unfortunately a symptomatic paradox, in our late capitalistic culture, that ‘the only appropriate word, “transcendent”, has been so misused that I hesitate to use it’ (Hayek, F. 1989, p. 729). Friedrich von Hayek provided a penetrating analysis of both orders typical of modern global capitalism, that of *cosmos* and *taxis*, nevertheless the idea of a transcendent ordering and supernatural power of an omniscient God is no longer acceptable for him (Hayek, o.c., pp. 72-73). God seems to be dead for Hayek but his belief with regard to the capitalist market was still alive.

The ‘secularization hypothesis’ was formulated some three decades ago in the modernization school of sociology, and it became a subject of research in today’s ‘economics of religion’. Faith in God and eternal life are to be explained as an endogenous variable dependent on economic development (GDP per capita, education, demographic or sexual revolution, growing life expectancy and ageing of population and so on).

One may have doubts about this theory, nevertheless I would appreciate some clarity of thinking esp. as to my point of *specie aeternitatis*. What I mean is: the ‘generalized utility theory’ and consumer behaviour in an infinite horizon concern not only ‘secular goods’ but also expected *post mortem* consumption. If the secularization hypothesis is valid, there is a historical

tendency to a loss of faith in eternal life. In a society of agnostics *post mortem* goods completely cease to exist and economic life is governed by laws *sub specie mortis*. A 'motive of salvation' has no meaning for the population of agnostics, and a 'motive of consumption' in a finite time horizon dominates the behaviour of people. For Manfred Spieker it is precisely this loss of faith in eternal life which is the deepest reason for the crisis of the 'welfare state' in Europe: there is no chance to finance health and pension systems for citizens living in the shadow of death (Spieker 1994). And I would only add that, according to Russian classical author F.M. Dostojevskij, if God does not exist, everything is allowed. The fear that a loss of faith would lead to a decline of morals, even agnostic Friedrich von Hayek was prepared to appreciate the role of religion as a 'beneficial superstition' in business. In his *Fatal Conceit* Hayek warned against 'the errors of socialism'. Nevertheless, religion reduced to a utilitarian calculus is in the end condemned to assist to another fatal conceit, that of a 'turbo-capitalism'. We have seen that a pure materialistic calculus with 'beneficial crimes' of privatization lead to a gangster economy in Russia and other post-communist countries (see Edward N. Lutwak's apotheosis of turbo-capitalism in the global economy – Lutwak 1998). Even more, only a few years later, when Lutwak's turbo-capitalism seemingly conquered the world and Twitchell's American materialism celebrated triumphs, the business leadership *sine specie aeternitatis* lead the world to the margin of a global catastrophe. Benefits of religious superstitions were not enough to balance moral hazard within a 'paradigm of greed and fear' in a short time horizon but in a globally unlimited dimension.

The crisis of welfare state *sub specie mortis* (Manfred Spieker) seems to concern just consumers and delusions of consumerism. But the lost perspective of eternity in our dominant culture is deeper, it is rooted in structures of property rights and patterns of production, in marketing communication, in a 'business culture'. Robert Keen at the Angelicum's 'The Good Company Conference' (Keen 2006) referring to MacIntyre's work *After Virtue* stresses 'that business leadership now has only an inadequate understanding of morality and possesses no proper comprehension of the "good" ...This...entails management's failure to admit any comprehension of transcendent'. Consequently, a fiction of moral neutrality of management only encourages moral quandary and indifference. Just in the same year (1981) when a *Theological Inquiry of Corporation* (Novak-Cooper, eds.) was published, MacIntyre rejected the claim that omnipresent pressure for effectiveness could be a morally neutral value. His warning about a manipulation

of human beings – with its contrivance of means – clearly showed that this instrumental thinking is incompatible with the moral Christian tradition. Keen further refers to Charles Taylor in a core argument that in the evaluation of the ‘good’ the function of transcendent is singular and crucial.

So, a business leadership *sine specie aeternitatis* suffers from the absence of adequate justification. Its long-term managerial effectiveness is doubtful. For those who still accept religion at least as a superstition, God remains an item in the risk analysis. Nevertheless business leaders without any glimpse of eternity are free to make their choices within a ‘paradigm of greed and fears’. There is no room for ‘good’ and ‘evil’ in an economics that has completely cut its roots with religion. The confusion of happiness and salvation with immanent forms of material prosperity is criticised as evident sin in *Caritas in Veritate* 34. I used the relevant sentence in the entrance motto of this paper. An interpretation of economic theory as a ‘theoretical physics’ imperially reigning within social science, that also serves our material prosperity, is a sign of our times of spiritual loss of way. No mathematical form of this ‘economic physics’ is able to give economics its ethos. But every science needs to have its own ethos. Neither is mathematics exempt from a temptation to be misused as an ideology.

Our business civilisation urgently needs more virtue, no doubt. Unfortunately, this deep need for virtue is in conflict with a new, technological totalitarianism born within our civilisation (Cardinal Martino presenting *Compendium* at the Montecassino Abbey, 30 April 2006). Moreover a universal hunger for liberty is innate in contemporary men. Nevertheless this hunger for liberty can lead men to a joyful vision only in the light of and with a glimpse of eternity, only *sub specie aeternitatis*. Without it, man is just a victim of market manipulation, a slave to the temptations of civilisation. Universal hunger for liberty needs a countervailing power of universal hunger for eternity.

Promises of terrestrial prosperity, i.e. of ‘sustained material progress’ (M. Novak) are features of political and election programs everywhere, and the business corporation has become the central institution of western and later also of global markets. It has evolved to fulfil these promises. R. Coase and O.E. Williamson explained where are the rational frontiers between the corporation and the market (*taxis* and *cosmos* in Hayek’s terms) and together with the principal-agent theory we acknowledge very big enterprises as typical for late capitalism. Within the corporation men are subjected to orders, loyalty, obedience and discipline in the name of rationality, and tempted by their own opportunism. Lynn Sharp Payne (Payne 2003) pointed to a moral

weakness of this cooperation between market and corporation: 'coagulations' of very big organizations can create orders endangering the cosmos of (global) markets, an adored cooperation between twins – orders *taxis* and *cosmos* suffer from apparent irrationalities. The reason is that corporation has 'lost its religious underpinnings' (Payne) according to jurisprudence experts that believe in the concept of the corporation's legal fiction. As a consequence, a doctrine of corporation amorality arises: business leadership *extra bonum et malum* – with only one exception, i.e. that of maximum profits. As the corporation has no body and soul, it is unable to sin by definition. Business leaders seem to be exempt from eternal punishment. In such a world, even the beneficial superstition of religion ceases to be needed.

From my long 'sabbatical' in a communist corporation I have some experience with such exculpations and attempts to evade responsibility. Both the old central planning machinery and contemporary global capitalism display one similar feature, which causes their extreme fragility. It is the phenomenon of 'bigness': a wilful moral hazard rooted in feelings that 'we have become too big to fail'. A calculus of this kind leads to extortion by governments and to new forms of rent and wealth-seeking behaviour. Look at this moral weakness of late capitalism: while profits are taken for granted as privates, losses of the 'sufficiently big' are socialized. This is a 'wisdom' based on moral hazard and the practice of extortion. I believe that for agnostic Hayek this kind of risky calculation, which endangers the stability of the system, would be just another 'fatal conceit', a new 'road to serfdom'. And a believer can remember the warning: the scripture says, 'I will destroy the wisdom of the wise...God traps the wise in their cleverness' (1 Corinthians, 1-3).

##### 5. IRRESPONSIBLE PRIORITY OF CAPITAL OVER LABOUR: THREATS OF GLOBAL DISORDER

Besides the extortional potential of 'bigness' to transfer risks and conquer new rents from the state, there are other negative features of the late capitalism. Shareholders that have lost *specie aeternitatis* from their 'inner model of perception of the world' seem to be 'unrestricted by spacial element' (Screpanti, E. – Zamagni, S. 2005). 'The investors' newly acquired mobility tends to give rise to a wide divergence, unprecedented in economic history, between economic power and social obligations...Today capital appears to have acquired a new freedom: no longer does it have to account to the people in the countries where its profits are made' (o.c., p. 457). An

extra-territorial status of economic power and the freedom it involves is still restricted by different tax and customs regimes. Nevertheless great players on global markets have a lot of degrees of freedom in their 'tax avoidance', 'tax evasion', 'creativity' in transfer pricing, in short, in 'tax optimization'. Another part of the cleverness of the wise concerns a different understanding of banking secrecy and various opportunities for money laundering. Investors and taxpayers are free in their choice of residence. The existence of tax paradises and even criminal sovereign states open questions about political roots in western parliamentary democracy that tolerates this clear hypocrisy. From time to time we are the victims of the operations of these structures of sin, but political will to face these forces of global disorder is strikingly missing. According to Professor Lynn Sharp Payne's warning, 'doctrine of corporate amorality is untenable...otherwise, we find ourselves living in an amoral society'.

I have found many of the points made above in the journal *Finance&Common Good*, esp. in No. 12/2002, 'Ethics of Taxation and Banking Secrecy'.

I argue that in the Catholic social doctrine all these examples of irresponsibility in a global space have to be described and analysed in terms of factual priority of capital over labour, and considered as completely opposite to the principle of the Church teaching. The meaning of the priority principle is different from that of Marx's class war between labour and capital: the Church doctrine stresses the need for cooperation and collaboration between employers and employees in the service of men. The former German CDU-CSU Minister for Social Affairs, N. Blüm, used a picture of marriage between labour and capital in this context, and his parable had its grounds in the post-war German Social Market Economy, where the institution of private property served the welfare of working men (Anton Rausher). N. Blüm says that today there is a divorce between labour and capital. To continue Blüm's parallel with family economics, I would add that capital-labour relations in the era of globalisation resemble unmarried cohabitation of couples living temporary together and even (globally) apart from each other. It is unlikely that a global common good can issue from this short-lived cohabitation – as a parallel to a likely disadvantageous conditions of children born outside marriage. In order to heal the dysfunctional relation between capital and labour, we urgently need 'a new wedding between labour and capital'. But this new beginning in the marriage of capital and labour has a small chance of taking place without a glimpse of eternity. Only *sub specie aeternitatis* would the capital be able and willing to respect the priority of labour and to serve to men.

## 6. A POSTSCRIPT: A HINT AT POSITIVE STORIES OF TRANSCENDENT ENTREPRENEURSHIP

My paper is devoted to a broader perspective analyzing the origins of crisis; consequently my attempt is affected by negativism. Considering the absence or deficit of the transcendent in contemporary business – *sine specie aeternitatis*, I am tempted to fall into negative thinking. Remembering the key advice of my late friend Milan Miskovsky – to adhere to positive thinking all the time – I end with three positive stories of business leadership *sub specie aeternitatis*. They demonstrate a sense for transcendent values in business and they are not just pious wants or fairy tales for adults. Looking at these good examples in our Czech economic history I realised that it can be a venture to make a choice from the recent history of one small nation – on top of it – a nation with a weak tradition of business leadership. Nevertheless two important anniversaries and one paper that turned up just in time encouraged me.

Recently (2008) we in the Czech Republic celebrated the 100-year anniversary of the death of architect, entrepreneur, first President of the Czech Academy of Sciences and Arts, and the greatest Czech Maecenas, Josef Hlávka. The Hlávka Foundation (1904) survived all political and social reversals in Central Europe, the communist expropriation included, and still provides research grants, scholarship and support for poor students. After the fall of communism – according to the last will of the Founder – holy mass is again celebrated in the chapel in the residence of Josef Hlávka twice a year. Hlávka's workroom in the residence looks like he left yesterday.

This April the Christian Democratic Party remembered another anniversary in the Czech Parliament: 75 years from the death of MP František (Francis) Nosek SFO. Brother Nosek is a candidate for beatification not only for the sanctity of his life as MP and minister. Francis was an exemplary husband and father of his family, a sponsor and organizer of social works and a developer and builder of several churches. But František Nosek was also a business and spiritual leader of the Czech people's capitalism, deeply rooted in Christ. An alliance of some 100 agriculture cooperatives and 70 mutual saving banks, with one bank at the top of the governance structure, successfully overcame the crisis and Great Depression after Nosek's death in 1935, World War II and the Nazi Protectorate period. Only communist nationalization after 1948 terminated Fratišek Nosek's businesses. In contrast to Josef Hlávka, Nosek didn't accumulate any real 'visible' capital; an MP and a banker, he died in absolute poverty. After his

death, a group of his friends and collaborators had to collect money for his funeral. A Franciscan entrepreneur – a contradiction *in adjecto*? No, just a businessman maximizing the wealth of his neighbours, devoted to the *post mortem* perspective. Trust as an invisible asset (K. Arrow) and trust in Almighty God, rather than almighty gold, were his maxims.

Among ‘all good things that come in threes’ – in preparing this paper I was interrupted by a request to write a report on a paper about Bata Management System. It was not so difficult to recognize the anonymous author: Professor Milan Zeleny (Fordham University, New York, and The Tomas Bata University in Zlín, Czech Republic), the Czech emigrant, helped me to fulfil a legacy of Milan (Miskovsky) to engage in positive thinking (See Zeleny 2010). Milan Zeleny’s story about the famous Czech entrepreneur and leader in the interwar shoe industry is a positive story par excellence. Moreover, Professor Zeleny comes with a very strong idea for the main goal of this PASS Annual conference about *Re-Planning the Journey* and finding a way out of the crisis in the global economy. The idea of ‘a built-in resilience against crisis at the micro level’ is a lesson taken from the history of BATA’s leadership. His case study is real, nevertheless it reads like a Utopia or a ‘miracle’: a flourishing company steadily growing during the time of crisis and the Great Depression, thanks to unprecedented resilience at the level of micro-economics. This ‘resilience’ had deeper roots, not only in the specific BATA system of management and organization, but also in the form of entrepreneurship, leadership, corporate governance and firm culture. Tomas Bata created a family firm in the multinational (today global) space. The Founder – just the first employee in the firm according to his own maxim – was asking every other employee to become ‘an entrepreneur in his position and working place’. Personal accounts of employees served as a very simple and transparent system of rewards and penalties, economic motivation with personal safeguards. No external capital was needed in this firm: re-investment of profits and savings from salaries was enough to finance the growth of the firm. Every business has a purpose; economics belongs to the teleology, not to *phusicos*-physic. The aim of Bata enterprises was to serve society and profit was just a mean to this purpose. Bata’s business was closer to the ideas of the last encyclical letter *Caritas in Veritate* (article 40) than to a standard capitalist enterprise.

In part 4.1 of his paper, Milan Zeleny (*The Purpose of Business*) shows a clearly different logic of shareholder company and that of Bata’s enterprises. Bata was first of all a producer of ‘invisible assets’ such as trust, human, social, and cultural capital, creativity of employees. This ‘resilience’

grew from a very special firm paternalism and partnership within the firm. It rested on the ability and willingness of the staff to accept Bata's recipe to face the crisis: a radical reduction in both expenses and prices of the company's shoes (by 50%). 'In a conversation with Mr. Sonnenschein, the CEO of Vítkovice metal works, Bata was asked how he expected his workers to survive a 40 percent wage cut. After informing him that he would supply them with essentials at highly subsidized prices, the steel baron facetiously asked Bata if he was also a grocer. Bata replied proudly: Yes, I am also a grocer'. (Zeleny, o.c., p. 110).

The Zlín region in the center of Moravia at that time was a more religious part of former Czechoslovakia. I do not know about the personal faith of Tomas Bata. Nevertheless I have chosen to use his personal credo as a memento from this essay about 'the singular and crucial function of the transcendent in the qualitative evaluation of "the good"' (Charles Taylor). This credo has convinced me that Bata was doing his business *sub specie aeternitatis* – regardless of the fact that his creed apparently had a secular form (Zeleny 2010, o.c., p. 112).

'Our life is the only thing in this world that we cannot consider to be our private property, as we have not contributed anything to its generation. It was only conferred to us with the obligation and expectation to pass it on to our posterity, multiplied and improved. Creation and enhancement of our own life is our duty and privilege: we are presenting the accounts of our conferred gifts of life to our contemporaries as well to the next generation. Our accounting should not end in a deficit, a loss, or impoverishment of our contemporaries and successors. We start with the "debit" and we end with the "credit" and only we are responsible for the final balance. Life is a capital and therefore it must, in the same way as a fertile seed, create something more, something to be left for the "spring sowing"'.  
 What to add? Perhaps just – Amen!

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# WHAT TO DO NEXT? A RESPONSE TO KEVIN RYAN

MICHAEL NOVAK

Kevin Ryan brings out significant empirical evidence that the world-wide economic crisis is harming families by bringing distress, discouragement, and even despair to millions of households. Rather than elaborate on these central points of his paper, which are well made, I would like to develop two hints that lie within it. Then I will turn to what courses of action a sound philosophy of economics would recommend, in order to remove these sufferings as quickly as possible.

## 1. THE FIRST HINT: THE CULTURAL CONTRADICTIONS OF CAPITALISM

To his credit, Professor Ryan does not emphasize only the damage done to families and individuals by this economic crisis, but also some undeniable good effects. Among these are a sharp reduction in personal debt, especially credit card debt (in the U.S. at least); a fresh awareness of the fact that marriage is more than an emotional bond, but also 'an economic partnership and social safety net'; a modest reduction (or at least postponement) of divorce; and less discretionary money for expensive vacations and diversions that take parents away from their children. Among the newly rediscovered economic advantages of family living are the paying job of a wife; a couple's commitment to pay down debt; and the willingness of in-laws to help out with rent-free living space and childcare. These ameliorations may be less visible or pressing than the damages done by the severe economic contraction. But they do raise anew questions posed by Daniel Bell's great book of 1976, *The Cultural Contradictions of Capitalism*.

Bell's thesis is that the very success of capitalism in producing wealth in broad and expanding circles throughout society injures the moral system that makes capitalism possible. In effect, Bell sees that contemporary capitalist systems are composed of three closely interrelated, but distinct,

social systems. These three may be designated as the political system, the economic system, and the moral/cultural system. These three systems each operate by different rules, and tend to attract different sorts of elites into the service of each different sorts of elites, each primarily committed to and shaped by that system's values. That the values of each are mutually complementary makes the unity of the three systems possible. That they are distinct and each different from the other makes the social balance among the three changeable. Sometimes one system becomes too strong for the other two, sometimes another.

One might hypothesize that during the sudden growth of American industry on a national scale – stimulated by the great Civil War of 1861-1865 and especially after the railroads spanned the eastern half of the country – the business system became more unified and stronger than the political system and moral/cultural system. Then at the time of the Social Gospel and the Progressive Movements of the years 1900-1950, and on account of the stresses of the two great World Wars, so many new powers were added to the Government that the political system became too powerful for the other two systems. Finally, with the enormous growth in new technologies of communication (radio, cinema, quick-drying ink that made the publishing of glossy news magazines possible, television, cell phones, computers, the Internet, Twitter, etc.), the elites of ideas, symbols, and public articulation laid hold of powers superior to those of governments and businesses. The moral/cultural elites even gained the power to ridicule old and stable values in the name of new moralities, fashions, and enthusiasms (indeed, the same cultural elites who were fascinated by 'The Coming Ice Age' in the 1980s waxed even more apocalyptic in the 1990s, this time about the destruction of Planet Earth through 'Global Warming').

The point is that the three distinct systems are necessary as checks and balances upon each other. However, shifts in the internal dynamism of each over time tend to alter the power relations among them.

Bell argues that the peculiar contradiction at the heart of *capitalist* systems that are *capitalist* in their economic system is that they depend on *moral habits* that the sudden, smashing successes of capitalism in the economic sphere tend to undermine. Capitalism is a system based upon *mind* (as the term 'capital' itself suggests) – that is, upon invention, discovery, cooperative organization, and the propensity to deny oneself present pleasures in order to save and to invest (at significant risk) in futures significantly different from the past. Yet its remarkably rapid social transformations encourage later generations simply to live off the profits of the past, to be significantly less self-denying, to live

rather more for the present, and to display significant dissipation of their resources and their energies. Thus does the economic system of capitalism tend to undermine the moral/cultural system to which gave it birth.

The evidence reported by Ryan suggests that, conversely, the crisis of capitalism obliges citizens to return in significant ways to the cultural practices and moral commitments that gave rise to the capitalist system in the first place. There may be some truth in that suggestion, and his insight should give rise to further empirical investigation.

## 2. THE SECOND HINT: THE ORIGIN OF THE HOUSING BUBBLE

The second hint buried in Ryan's text may easily be highlighted in his opening sentence:

This global financial collapse, *which began with the U.S. housing bubble*, has rippled through central banks, stock markets across the globe, and crossed the loss of an estimated fifteen trillion dollars of consumer wealth.

So far as I can see, not being an economist, there seems to be virtually universal agreement that the current economic crisis did indeed begin in the U.S. housing bubble. But what caused the housing bubble? Much hinges on the answer to that question.

It so happens that my economist colleagues at the American Enterprise Institute were predicting this collapse nearly a decade before it was to happen, and strongly recommending corrective action before it became too late. AEI is a private research center which specializes in anticipating the unintended effects of policies, private and public. In this case, my colleagues had correctly identified one immensely destructive policy of the United States Congress – promoting mortgage lending to people of very low income through off-budget guarantees and lax lending standards (rather than explicit, on-budget subsidies) which disguised the substantial risks to the financial system as a whole.<sup>1</sup>

<sup>1</sup> See Peter J. Wallison and Bert Ely, *Nationalizing Mortgage Risk: The Growth of Fannie Mae and Freddie Mac* (AEI Press 2000); Peter J. Wallison (ed.) *Serving Two Masters Yet Out of Control: Fannie Mae and Freddie Mac* (AEI Press 2001); and many other publications and conferences posted at [www.aei.org/basicPages/20040927152122935](http://www.aei.org/basicPages/20040927152122935). Cf. Peter J. Wallison, 'Cause and Effect: Government Policies and the Financial Crisis', *AEI Financial Services Outlook*, November 2008, posted at [www.aei.org/outlook/29015](http://www.aei.org/outlook/29015).

The two giant 'GSEs' (government sponsored enterprises), Fannie Mae and Freddie Mac, supplied hundreds of billions of dollars of government-guaranteed loans for 'subprime' mortgages, while the bank regulators pressured banks to relax traditional lending standards dramatically and to increase their mortgage lending. Much public praise (including, alas, from me) was lavished on 'Fannie and Freddie' for making millions of poor families owners of their own homes. What was overlooked was that the homes were really owned by the banks and other lenders – and that the families had been loaded with far more debt than they could afford when and if housing prices fell, as of course they did.

The intentions behind these federal laws were entirely benevolent and moral. Congress wished more and more lower-income people to qualify for mortgages, so that they, too might benefit by the pleasures and responsibilities of owning their own homes. However, the unintended *effects* of these laws were to invite speculators among the middle class, and the wealthy also, to apply for these cheap and guaranteed mortgages (in order to buy second homes). Such persons were more likely to benefit than poor persons heretofore excluded from home ownership.

These second mortgages, moreover, were *guaranteed* by the government in a way no other mortgage lender could match. No wonder that about sixty percent of all mortgages during the period just before the financial crisis were granted by Fannie Mae and Freddie Mac.

In fact, it has been reported that half or more of all the mortgages granted in the state of Florida, a state highly favored by many retired folks, were to persons taking out mortgages on second homes, in a kind of speculative bet that future values would steadily rise. When that hope was not realized, the market price of homes collapsed, and it became cheaper for many to foreclose on their loans, rather than to pay the escalating interest charges to which they had consented.

This huge set of unintended consequences, flowing from an ill-conceived government policy, could not, of course, be contained within the housing market alone. Private banks all around the world purchased the loans made by Fannie Mae and Freddie Mac (who were after all the original grantors of these mortgages, but not their long-term holders). Worse still, these private home mortgages, not subject to the same rigorous green-eyeshade scrutiny as in the past, were not sold individually to secondary banks. They were sold, rather, in anonymous 'bundles'. Then when individual mortgages began to go bad, as it had been clearly foreseen by my colleagues that they would, the new owners of these bundles of mortgages had no way of knowing just how many bad ones might be in the particular bun-

dles they had bought. From being in possession of a reliable stream of income from well-backed mortgages, they faced the shock of financial uncertainty and a significant devaluing of their assets.

I do not wish to make the point that government policy is alone responsible for the current crisis. Rather, only that it played an originating part in the falling of the house built of cards that my colleagues had identified almost a decade earlier. There was enough blame to go around, especially since, when the approaching crisis was swiftly approaching, there was no sustained public outcry against the original federal laws. In the short run, many people were benefiting from this misguided policy.<sup>2</sup>

### 3. SOME GOOD NEWS FROM THE LAST FORTY YEARS

Meanwhile, other colleagues of mine at AEI have closely studied the great decline in the number of poor persons on earth who earn less than \$1.00 per day. In 1970, that number had reached 968 million. By 2006, the number was driven down to 350 million. During that time, the earth's population had increased by three billion. Nonetheless, the number of poor persons shrank tremendously, by 64 percent.<sup>3</sup> If intellectual, political and church leaders can keep that process going for another thirty years, the remaining 350 million ought essentially to have been freed from poverty.

Almost all this progress had been made in China and India, which were not long ago the countries with the highest number of poor persons. Since about 1980, however, China and India together have moved considerably more than half a billion persons out of poverty and up to one rung or other of the middle class. This was one of the greatest anti-poverty successes in history, rivaling the great material progress of Europe between 1800 and 1900. During that century, the income of a British worker had risen by sixteen hundred percent.<sup>4</sup> Foods, beverages, and textiles never before available even to better-off persons entered the workers' daily lives.

<sup>2</sup> For more on the causes of the housing crisis, see Thomas Sowell, *The Housing Boom and Bust* (Basic Books, 2009).

<sup>3</sup> See Maxim Pinkovskiy and Xavier Sala-Martin, 'Parametric Estimations of the World Distribution of Income' (2005, NBER Working Paper 15433).

<sup>4</sup> See Paul Johnson, 'Has Capitalism a Future?' in Ernest W. Lefever, ed., *Will Capitalism Survive?* (Washington, D.C., Ethics and Public Policy Center, 1979), p. 4. Also see Ludwig von Mises, ed., *The Anti-Capitalist Mentality* (Princeton: D. Van Nostrand Company, Inc., 1956); and Friedrich von Hayek, *Capitalism and the Historians* (Chicago: University of Chicago Press, 1954).

In the case of both China and India during the last forty years, these results were the fruit of moving from a socialist command economy to one based on private property, open markets, private profit, and personal enterprise. That is the very method that raised standards of living so notably in Europe during the 1900s. In 1859, Abraham Lincoln himself described the range of new international products that were already showing up in the American West:

Look around at Young America. Look at his apparel, and you shall see cotton fabrics from Manchester and Lowell; flax-linen from Ireland; wood-cloth from Spain; silk from France; furs from the Arctic regions, with a buffalo robe from the Rocky Mountains.

And on 'Young America's' table, one can find:

besides plain bread and meat made at home...sugar from Louisiana; coffee and fruits from the tropics; salt from Turk's Island; fish from New-foundland; tea from China, and spices from the Indies. The whale of the Pacific furnishes his candle-light; he has a diamond-ring from Brazil; a gold-watch from California, and a Spanish cigar from Havanna.<sup>5</sup>

In other words, the sudden prosperity of the United States so soon after its founding is now being replicated in Asia.

I wrote some years ago that during the first thirty years of the new millennium the main moral task would be to reduce drastically the numbers of the world's poorest persons. There seemed to me no reason written in the stars why this Earth should have so many poor people. The cause of poverty seems directly linked to poorly designed human systems for creating new wealth, and an abysmal failure to teach all peoples how to shape their habits and daily practices, in order to become creators of new wealth. Sound economic habits and skills of enterprise and invention are quite natural to the human species, and only need to be taught and encouraged in order to blossom.

At that time, I did not anticipate the relatively sudden structural shift of two of the most populous and also very poorest countries, China and India, into capitalist economies. Once, Asia was the world's continent with the highest numbers of the poor. Nowadays, the focus of neediness shifts to Africa,

<sup>5</sup> See Abraham Lincoln, 'Lecture on Discoveries and Inventions', Jacksonville, Illinois, February 11, 1859, in *Speeches and Writings: 1859-1865* (Washington D.C.: Library of America, 1989), p. 4.

and to the remoter regions of Latin America. Many (but not all) remote regions stand 'outside the circle of development', which spreads outwards from free economic systems. The road ahead is still long. But it is only wise to take encouragement in this difficult work from successes recently won.

Another stunning example of the progress of the poor during the past forty years can be found in the recent study by the United States Census Bureau on the *Living Conditions of the United States 2005*, with detailed reports on the *Percent of Households Reporting Consumer Durables*.<sup>6</sup> This study compares the results from 2005 to those in 1971 by a number of selected characteristics, amongst them households below the poverty line.

My colleague Mark J. Perry summarizes the survey thus:

Certain appliances such as air conditioning, clothes dryers, color TVs, and dishwashers that used to be luxury items owned by a minority of American households in 1971 became so affordable that by 2005 a large majority of households owned all of those appliances. And some household items such as microwave ovens, VCRs, computers and cell phones that were virtually nonexistent in 1971 became so affordable that more than two out of every three American households owned these items.

**Household Appliance Ownership:  
1971 (All) vs. 2005 (Poor) vs. 2005 (All)**

Household Appliance Ownership (%)	1971: All Households	2005: Poor Households	2005: All Households
Washing Machine	71.3%	68.7%	84.2%
Clothes Dryer	44.5	61.2	81.2
Dishwasher	18.8	36.7	64.0
Refrigerator	83.3	98.5	99.3
Freezer	32.2	25.1	36.6
Stove	87.0	97.0	98.8
Microwave Oven	1.0	91.2	96.4
Color TV	43.3	97.4	98.9
VCR	0.0	83.6	92.2
Personal Computer	0.0	42.4	67.1
Telephone	93.0	79.8	90.6
Air Conditioner	31.8	78.8	85.7
Cellular Phone	0.0	48.3	71.3

Source: U.S. Census Bureau

<sup>6</sup> U.S. Census Bureau, Survey of Income and Program Participation, 2004 Panel, Wave 5. Internet Release date: November, 2009.

Perry also cites economist Steve Horwitz for a yet more startling overview of the relevant statistical tables:

Life for the average American is better today than 35 years ago, life for poor Americans is better than it was 35 years ago, and poor Americans today largely live better than the average American did 35 years ago.

Explains Perry:

By almost every measure of appliance measurement, poor American households in 2005 had much better living conditions than the average American household in 1971, since poor households in 2005 had much higher ownership rates for basic appliances like clothes dryers, dishwashers, color TVs, and air conditioners than all households did in 1971.<sup>7</sup>

Again, it takes many fewer hours of work in 2009 than in 1973 to purchase these household appliances. In other words, there is more than one way to make the poor better off.

**Time Cost of Common Household Appliances (Hours Worked), 1973 vs. 2009**

Household Appliances	1973		2009		% Change 1973 to 2009
	Retail Price	Hours of Work @ \$4.12/hr.	Retail Price	Hours of Work @ \$18.72/hr.	
Washing Machine	\$285	49.2	\$400	21.4	-69.1%
Clothes Dryer	\$185	44.9	\$400	21.4	-52.4%
Dishwasher	\$310	75.2	\$570	30.4	-59.5%
Refrigerator	\$370	89.8	\$425	22.7	-74.7%
Freezer	\$240	58.3	\$265	14.2	-75.7%
Stove	\$290	70.4	\$650	34.7	-50.7%
Color TV	\$400	97.1	\$300	16.0	-83.5%
Coffee Pot	\$37	9.0	\$30	1.6	-82.2%
Blender	\$40	9.7	\$32	1.7	-82.4%
Toaster	\$25	6.1	\$30	1.6	-73.6%
Vacuum Cleaner	\$90	21.8	\$100	5.3	-75.5%
	\$2,272	551.5 hrs.	\$3,202	171 hrs.	-69.0%

It is right and just for measures of what counts as poverty to go up decade by decade, even though after forty years the poor live better than the average household did four decades earlier.

<sup>7</sup> See Mark J. Perry, 'The Rich Are Getting Richer and The Poor Are Getting Richer', [Weblog Entry] *The Enterprise Blog*, American Enterprise Institute, 1 Dec. 2009 (blog.american.com/?p=7694). Accessed 23 March 2010.

It discourages further progress, however, not to notice strong progress in the immediate past.

#### 4. WHAT TO DO NEXT?

'If you had your way, what programs would you propose in order to end poverty such as we recently saw in Bolivia and Brazil (or some similar location)?' Pope John Paul II (or more likely, Archbishop Dziwicz) asked me more than once at the dinner table in his Apartments.

Reminding them of the obvious, that I am not an economist, I always made three simple yet basic recommendations:

1. Since the most dynamic form of capital is human capital, give priority to social spending to expand and improve education. Along with that, put new emphasis on economic creativity, enterprise, wit and invention (which in *Centesimus Annus* the Holy Father identifies as the chief cause of the wealth of nations today).<sup>8</sup>
2. In order to supply the millions of new jobs desperately needed among the unemployed (and underemployed) in many poor countries, make it easier for poor persons to form economic associations such as small businesses, under the protection of limited liability, so that they do not put at risk the whole well-being of their families in their new ventures. Hernando de Soto has studied the exorbitant costs in fees and bribes paid, in many Latin American countries.<sup>9</sup> By contrast, the legal process of incorporation in Hong Kong is low (about thirty U.S. dollars), quick (less than a month), and executed by mail on a simple form. Human beings have a natural right to association (first vindicated by St. Thomas Aquinas in *Contra Impugnantes Religionem*), and any nation wishing to escape poverty must help unleash the economic creativity of the poor. It is virtually criminal to exclude the poor from the right to form business associations, and to do so quickly and cheaply.

<sup>8</sup> See CA 32: 'In our time, in particular, there exists another form of ownership which is becoming no less important than land: *the possession of know-how, technology and skill*. The wealth of the industrialized nations is based much more on this kind of ownership than on natural resources'.

<sup>9</sup> See Hernando de Soto, *The Other Path: the Invisible Revolution in the Third World* (New York: HarperCollins, 1989), 11, 12, 13.

Most new jobs are created by small businesses employing between three and twenty-five persons. So it is good (even indispensable) policy to help these to be founded easily, quickly, and cheaply. It is also wise for caring leaders to keep their eyes on the rate of small-business formations in their nation or district, as the best indicator of progress against unemployment and underemployment. Without rapidly increasing employment in the private sector, a nation is unlikely to grow out of poverty.

3. Since poor people lack the personal capital to buy materials or to pay collaborators *before* they begin operations, government must help by establishing legal, helpful small credit bureaus in every locality, which offer practical advice as well as advance funding – and at the lowest possible rates. Such credit bureaus offer practical advice because they want their lenders to succeed, and thus to pay back in a regular stream the moneys they have borrowed. In this way, these mini-loans can be recycled to still other entrepreneurs. Archbishop Mark McGrath, of some fame at Vatican Council II, developed such a scheme of recycling small loans in Panama, to considerable good effect.

In other words, governments should focus on educating and supporting many women and men of enterprise, especially among the poor, who will create new jobs, new products, new services and, in the end, new national wealth. Such progress at the bottom is the best method for bringing the fruits of new wealth to the grassroots of society, where in a relatively short time (as we learn from all the ‘Asia tigers’) persons of considerable economic genius will begin to emerge. For the Lord has spread economic talents abroad like the sower sowing his seed.

## 5. CONCLUDING REMARKS

For more than 180 years, ever since Karl Marx popularized the term and gave it a derogatory meaning, important intellectual forces in the world have denigrated ‘capitalism’. Usually, this is because they wish to boost by mere words a rival form of economy. If any of us could collect a nickel for every derogatory use of the word ‘capitalism’, we would earn considerable wealth.

During the era in which capitalism began to flourish in human history – in the 17th and 18th centuries – the usual motivation for denigrating it has

been to collect more power in the hands of the State. The usual rationalization for this collectivization is to 'regulate', 'correct', and 'direct' the market.

Up to a point, a certain degree of regulation is advantageous to the economy itself, and thus to businesses, just as it is necessary in team sports to set down in advance clear rules. In fact, businesses themselves often ask for regulation, in order to protect patents or other advantages of their own. Thus, the drive toward regulation is commendable. But carried too far, it is self-injuring. That is how congressional actions to force the U.S. housing market into narrow channels built a house of cards, whose collapse led to a chain of collapses in other financial markets.<sup>10</sup>

The lust of political elites for more and more control over economic activity is always a danger against which wise societies take strong precautions. Today, new myths such as 'global freezing' in the 1980s, and 'global warming' since the 1990s, have stimulated new lusts for government control over economic activism and economic creativity. The motives are said to be good, sweet, and pure.

There seem never to be lacking those who would suffocate economic activists and creators of new wealth in the name of 'helping' them. But experience shows us wise ways to regulate and unwise ways – destructive ways and creative ways. We must always ask, quite realistically, and close to experience, what actually liberates the poor from poverty and unemployment? In the long run, it cannot be the State. Historically, nothing so broadly liberates the poor as creative economic activism.

Today, more than ever, elites who form and transmit ideas have gained disproportionate power over the politically wise and the economically creative. Thus it is more important than in earlier times to keep our eyes on practical and realistic ways of breaking the chains of poverty among the very poorest people. These are quite often not only unknown to but strongly resisted by the head-shaking classes.

In the real world (the world of actual experience), certain systems, methods, learned habits, virtues, and practices have worked wonders in liberating (quite recently) an immense proportion of the world's population. They have done so even while the world's population has doubled three times since the year 1800 (from one billion to two, from two to four, and

<sup>10</sup> See Kevin Hassett, 'How the Democrats Created the Financial Crisis', *www.bloomberg.com*, September 22, 2008, posted at [www.bloomberg.com/apps/news?pid=newsarchive&sid=aSKSoiNbnQY0](http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aSKSoiNbnQY0).

now from four to steadily heading toward eight billion). Both population growth and liberation from poverty have come together in tandem, due to marvels in the advances of medical knowledge and medical technology. These advances, in turn, have been made possible by wealth newly created through astonishing inventions in countries sometimes denigrated as 'capitalist'. These denigrations would be less dishonorable if they displayed a proper understanding of what that system really is, and how it really works. It is a system with many serious faults. It is a poor system, until compared to all the others. It has no peer in lifting the world's poor out of poverty.

It was only about two hundred years ago that the Christian West moved (against Malthus) to lift the cruel burden of poverty from the whole human race. The persisting aim was to help today's poor to live at standards of living unattainable by even the wealthiest persons in 1776. At that time, the dream of 'universal affluence' was first voiced by Adam Smith in tiny and then not very wealthy Scotland. Thus was born the liberating idea of economic development.

Fortunately, in the profound study laid out in *Centesimus Annus*, Pope John Paul II gave the free economy its due (especially in sections 31-42), under proper, fruitful safeguards. Economists and philosophers of economics do well carefully to measure his achievement. He did much in that place to be a 'witness to hope' for the world's poorest.

## REPLY TO LUBOMÍR MLČOCH

MICHAEL NOVAK

Professor Mlčoch's excellent paper arrived too late for me to reply to him along with my reply to Kevin Ryan. I agree entirely with Mlčoch's principal thesis: that without reference to the transcendent, one can not have a morality that is truly humanistic, which also corrects the 'spirit of the age' generation after generation. On a minor point, however, Mlčoch quotes me in a way as though I disagree with him, but the full quote shows that I stand foursquare with him.<sup>1</sup>

Further, like many well-intentioned Europeans, Professor Mlčoch also reads the United States as if it were more like Europe than it is. He does not grasp the acute differences, especially on religious matters, between the

<sup>1</sup> Mlčoch references the Question and Answer portion of *The Corporation: A Theological Inquiry* (AEI Press, 1981) and infers I prefer to place emphasis on the descriptive 'is' instead of the normative 'ought'. The full quote reads as follows:

Questioner: ...You were responding to a question that ends with '...Don't we need a recognition that people are whole, that they have other interests in life besides their area of specialization?'

Mr Novak: Well said. It is beginning to happen. Expertise, as an ideal, has had a very short history. In the 1930s, university professors used to be regarded as absent-minded professors. They were not thought to be experts, or hardly so. It was after World War II, with its great explosion of technical knowledge, that the cultivation of the expert took hold. I can remember at Harvard, in graduate school, being told that it is wrong to be too worried about the 'ought'; the crucial thing is to be right about the 'is'. We were taught the importance of the descriptive and warned against the normative. John Kennedy remarked in 1963, at Yale, that we now know how to solve most of the problems of world poverty; the only question is whether we have the will to do so. To my mind, that was the high point of the hubris of the experts. Ever since then, there has been growing skepticism about them. In a sense, the experts are always wrong when they address a whole problem because, in the nature of the case, they are expert in only one facet of the problem, while nothing in life comes with one facet only.

United States and Europe, not least America's original and still frank and energizing recognition of the role of the transcendent in the public and private life of the United States.

Pope Benedict XVI has lately insisted more than once that the Church needs to study more carefully the tradition of religion and liberty in the United States, which is so different from the traditions of Europe after the French Revolution.<sup>2</sup>

A recent book just published in Italy recalls a campaign event in 2008, in which one of the major presidential candidates is asked by a fellow Senator at a public hearing: 'Senator, do you believe that God intervenes in history and rewards or punishes people or nations in real time for their behavior?'<sup>3</sup> Such a question is almost unimaginable in any nation in Europe. It hardly raises a ruffle in the United States. Indeed, it is comfortably traditional and well expected.

The assumption behind this question is that the people of the United States are a highly religious people, with a strong historical commitment to the transcendent God of the Jewish and Christian tradition. The very first public document of the new nation, its Declaration of Independence in 1776, appeals to the transcendent God of the Bible at least four times (as Governor, Creator, Judge, and Divine Providence). Further, a favorite name for the new 'experiment in liberty' in the United States was the 'Second Israel'.<sup>4</sup>

The voyage across the sea from Europe to America was taken to echo the flight of the Israelites through the Red Sea. The movement through the Westward Wilderness was understood to parallel the journey of the Israelites across the Desert. The aim of the Pilgrims ('to build a shining City on the Hill') was meant to echo the aim of the People of Israel seeking to re-enter Jerusalem.

One often encounters in European publications writers who mock these extravagant religious claims. In a much more secular culture, such claims seem outlandish, and even dangerous, in any case ridiculous. In

<sup>2</sup> See Benedict XVI's Address to U.S. Bishops, April 16, 2008: 'It strikes me as significant that here in America, unlike many places in Europe, the secular mentality has not been intrinsically opposed to religion. Within the context of the separation of Church and State, American society has always been marked by a fundamental respect for religion and its public role, and, if polls are to be believed, the American people are deeply religious'.

<sup>3</sup> Alessandro Gisotti, *God and Obama. Faith and Politics at the White House* (Effatà, 2010) p. 1.

<sup>4</sup> Ezra Stiles, 'The United States Elevated to Glory and Honour' (1783), in Conrad Cherry, ed., *God's New Israel* (Englewood Cliffs, NJ: Prentice Hall, 1971), p. 83.

the United States, though, now as at the Founding, these claims are expected and demanded.

Today, of course, the nation faces a spiritual crisis. For the last sixty years, a growing group of 'secularizers' has been trying to 'drive religion out of the public square' and to de-Christianize our nation.<sup>5</sup> The great sociologist Peter Berger, one of the world's leading social thinkers, has quipped that if the people of India are among the most religious in the world, and if the most secular people in the world are the Swedes, then America today is best understood as a population of Indians, ruled by an elite of Swedes. We are now engaged, in America, in a great 'culture war', testing whether our nation, or any modern nation, can long continue to dwell under the judgment of the Transcendent, steadily recognized in public speech and action.

In the middle of this battle, even unintentionally, an analysis such as that of Professor Mlčoch furthers the work of the secularizers. He repeats their arguments as if they were true, viz, that the U.S. is a secular nation. He makes life more difficult for those of us insisting on the transcendent values and commitments that have always marked our nation's history.

In short, publicly available evidence does not allow one to claim that the people of the United States, as distinguished sharply from the far more secular peoples of Western Europe, are now secular. On the contrary, the United States was born, and still continues, under the light of eternity, in the full gaze of the Lord Judge of Israel, the God who judges consciences and intentions and soul, not merely outward performance. No doubt His judgment of us needs often to be severe. He has exacted of us even in the century just past, in His justice, an immense treasure in expenses and in blood.

Let me propose to this world-esteemed Academy a modest study of the State documents of the United States from the beginning until now. Their lineage is virtually unbroken in their degree of explicit confession of the Creator, Judge, and Governor in the daily life of this nation and this people. You may hate it, or fear it, simply not understand how it works, or ridicule it. But for better or worse, you cannot deny it.

Allow me to present some of the less familiar, but basic, evidence from history. For example, the General Orders of General Washington to his troops during the seven-year bitter war for Independence – independence from another Christian power, the United Kingdom, whose soldiers read

<sup>5</sup> See Richard John Neuhaus, *The Naked Public Square: Religion and Democracy in America* (Eerdmans, 1986).

the same Bible and believed in the same Providence. To take just one example from many: 'Let us therefore rely upon the goodness of the Cause, and the aid of the Supreme Being, in whose hand Victory is, to animate and encourage us to great and noble Actions'.<sup>6</sup>

Recognizing that, the Americans – even the Bible-hating Tom Paine – believed that the God of Liberty, the God of Conscience, could not possibly fail to sustain those fighting for liberty, and to rebuff those (however well-meaning, and within their rights) who were fighting to prevent their independence and their liberty:

I have as little superstition in me as any man living, but my secret opinion has ever been, and still is, that God Almighty will not give up a people to military destruction, or leave them unsupportedly to perish, who have so earnestly and so repeatedly sought to avoid the calamities of war, by every decent method which wisdom could invent. Neither have I so much of the infidel in me, as to suppose that He has relinquished the government of the world, and given us up to the care of devils; and as I do not, I cannot see on what grounds the king of Britain can look up to heaven for help against us.<sup>7</sup>

Or consider the official, public Proclamations of the Congress every year after the Declaration of Independence, calling for a Day of Repentance, for all the sins of the nation and of its individual members, in order to be able to pray for God's blessing on America, in its original purpose of gaining their liberty.<sup>8</sup> And later of annual Days of Thanksgiving, to note explicitly and to give thanks for the 'signal blessings' by which in month

<sup>6</sup> Jared Sparkes, ed., *The Writings of George Washington*, vol. 12 (Boston: American Stationers' Company, 1837), 411. For those who do not find it convenient to look into official State documents regarding the sense of the transcendent in the public governmental liturgies of the United States, as well as in popular culture, I have made some available in (an over-long) Appendix (see Appendix 1 of my *Washington's God* [New York: Basic Books, 2006]).

<sup>7</sup> Thomas Paine *The American Crisis No. 1* (1776).

<sup>8</sup> See the Congressional Fast Day Proclamation of March 16, 1776: 'In times of impending calamity and distress; when the liberties of America are imminently endangered by the secret machinations and open assaults of an insidious and vindictive administration, it becomes the indispensable duty of these hitherto free and happy colonies, with true penitence of heart, and the most reverent devotion, publicly to acknowledge the overruling providence of God; to confess and deplore our offences against him; and to supplicate his interposition for averting the threatened danger, and prospering our strenuous efforts in the cause of freedom, virtue, and prosperity' (*Journals of the American Congress From 1774 to 1788* [Washington, D.C.: Way and Gideon, 1823]), 1:286-287.

after month the Almighty seemed to rescue, or to save, the American cause, against all odds.<sup>9</sup>

The Americans – or perhaps only an active quarter of them – took up arms heroically against the most powerful navy in all the world, and against one of the two great armies of the world (the other being that of France), even as the Americans began their struggle with no trained army, no navy, and no munitions factory on their side of the ocean. No wonder in the Declaration they placed their hope and reliance ‘upon Divine Providence’ for the success of their arms. What else did they have, except the God of Liberty?

No wonder this people took as the motto to be impressed on their coinage ‘In God We Trust’. Mock them for this if you wish, but do not deny to them their seriousness and the depth of their trust, even in the direst and darkest days of their long experiment. The U.S. is now the longest-lived democratic republic in the world – and the most religious.

If you doubt the depth of the American sense of the transcendent in daily life, check out the Inaugural Address of every President since the beginning. Read Jefferson’s Bill for Religious Liberty and his argument supporting it, which relies heavily on the will of God to make men free, when He need not have, and to judge them by their inner conscience, not solely their outward acts:

Well aware that the opinions and belief of men depend not on their own will, but follow involuntarily the evidence proposed to their minds, that Almighty God hath created the mind free, and manifested his Supreme will that free it shall remain, by making it altogether insusceptible of restraint: That all attempts to influence it by temporal punishments or burthens, or by civil incapacitations, tend only to beget habits of hypocrisy and meanness, and are a departure from the plan of the holy author of our religion, who being Lord both of body and mind, yet chose not to propagate it by coercions on either, as was in his Almighty power to do, but to extend it by its influence on reason alone.<sup>10</sup>

Read also Abraham Lincoln’s Second Inaugural, delivered March 4, 1865, wherein he reflects on the actions of Providence and Divine Justice, in exacting a drop of blood on the battlefield of the great Civil War of 1861-

<sup>9</sup> To see all Congressional documents regarding religion and the founding of the American republic, visit the Library of Congress webpage [www.loc.gov/exhibits/religion/rel04.html](http://www.loc.gov/exhibits/religion/rel04.html).

<sup>10</sup> Thomas Jefferson, *A Bill For Establishing Religious Freedom* (Papers 2: facing 305) June 12, 1779.

1865, one drop for every drop of blood shed by an innocent, unwilling slave held in captivity. That Civil War was the bloodiest war in all history until that time, fought by two Christian armies each sure that its cause was just. In his Second Inaugural Lincoln tried to take the point of view of Divine Justice and Providence, looking down on the cause of each:

It may seem strange that any men should dare ask a just God's assistance in wringing their bread from the sweat of other men's faces, but let us judge not, that we be not judged. The prayers of both could not be answered. That of neither has been answered fully. The Almighty has His own purposes.

Lincoln ended with the most famous refrain: 'With malice toward none, with charity toward all', in his plea for national reconciliation. Not long afterwards he died a martyr. Many have judged that this is the deepest, most truthful, most authentic, and most prudent appeal to the transcendent God by any political leader, in wartime, in all of modern history. It is certainly among the very best.

G.K. Chesterton, the great English convert of the early 20th century, wrote after his voyage to America that America is different from other nations: 'It is a nation with the soul of a Church'. Its Declaration of Independence states its creed. All its political liturgies are staged, expressly, in the light of the transcendent. The Inauguration of America's Presidents is a religious ceremony from start to finish. So are its political speeches on national holidays and, indeed, throughout the year.

Today, crucial holes are being punched in this sense of the transcendent long nourished by public religious traditions of the country. The aggressors during the past sixty years in this determined war against religion are many in the elites of the law, journalism, the movie and television industries, and other elites of the symbol-wielding class.

It is this internal civil war, a cultural war, a war of symbols and self-understanding, that is directly responsible for foisting a regime of abortion off on a unwilling public. The American people have not in any single election in any single district given to abortion their consent. In fact, even today, there are abortion 'clinics' (houses of death) in only thirteen percent of all the counties in the United States. The elites fervently protect the abortion license. But over half the people oppose the current unbounded nine-month legal protection given to abortionists. Right up to the moment when the infant is half born and half still in the womb – and under boundaries far more extreme than in Europe – the American abortionist may practice his disgusting craft.

Analogously, the elites of the U.S. communication industry seem almost never to portray in their films the way in which the ordinary people of the United States, the large majority, actually live their religious lives, how they meet cancer or other anguish in the family, or face the automobile deaths of classmates on the highways, at prayer and in community with their brothers and sisters in the faith. In the media, Americans are portrayed as a pagan people, which in the main they are not.

After September 11, huge majorities of Americans in their grief and shock attended special services in every church and synagogue, and often with candlelight in city squares and on university campuses. And the response of our people with song and flag, for many weeks after September 11, was a robust singing of the most popular of national hymns, 'God Bless America'.

The third stanza of yet another popular hymn, 'America the Beautiful', is my personal favorite, for its description of 'ordered liberty':

O! Beautiful for Pilgrims' feet, whose stern impassioned stress  
A thoroughfare for freedom built, across the wilderness.  
America! America! God mend thine every flaw.  
Confirm thy soul in self-control, thy liberty in law.

At the risk of excess, then, let me report just one more stanza, from the Battle Hymn of the Republic, Lincoln's army, the army whose aim was to preserve the Union, so that slavery would be put on the peaceful road to destruction by growing and expanding popular electoral majorities. That stanza runs:

In the beauty of the lilies Christ was born across the sea,  
With a glory in His bosom that transfigures you and me:  
As He died to make men holy, let us die to make men free,  
While God is marching on.

As it happens, furthermore, Professor Mlčoch's splendid paper came into my hands just on the day when a new poll was released on the religion of the American people, by one of the most respected of all national pollsters, the Rasmussen poll. Fifty-seven percent of adult Americans report that religion is 'very important' in their daily lives, and another twenty-three percent say that it is 'somewhat' important, for a total of eighty percent. Only eighteen percent give the answer one would take as normal in any Western European country, that religion in their daily lives is of 'no importance'. That answer is most frequently given in America by the young and the unmarried.<sup>11</sup> This is, perhaps, as one would expect.

<sup>11</sup> '80% Say Religious Faith is Important to Their Daily Lives', *Rasmussen Reports*, April 25, 2010, [www.rasmussenreports.com/content/view/full/28820](http://www.rasmussenreports.com/content/view/full/28820).

Finally, I cannot refrain from reporting that studies of religious convictions among America's elites, divided into about fifty different professions, show that the least religious elites are journalists and filmmakers for Hollywood and for television, the law profession, and political operatives.<sup>12</sup> The most religious elites are the clergy, the military, professional athletes, and people in business. My hypothesis is that these latter more religious professions daily experience serious contingencies, including (in the military and in sports) injury and death. They are far more attuned to the role of contingency in human events – and, therefore, to the role of Divine Providence in their failures and successes.

To say, after reviewing the abundant, even overwhelming evidence, that the Transcendent does *not* figure in the political culture of the United States, is to fail to grasp the essential way in which Americans have diverged from the example of secular Europe. In matters of religion, Europe is the Western rule; the United States is the exception. But Americans are closer to the multitudes of religious people in the less developed world, and Europe is like a secular island in an ocean of turbulent religious energies, to use the image employed by Jürgen Habermas.

The evidence is overwhelming that large majorities in the United States today, following in the well-worn path of the most important public documents in our national life, appeal often and publicly to the force of the Transcendent in human affairs. Many also try to live faithfully under it. The evidence is equally strong that a significant and most powerful minority are working to overturn that long tradition.

The current struggle between these forces is likely to be long, its outcome uncertain. We can use all the help we can get.

<sup>12</sup> See *Business as a Calling* (New York: The Free Press, 1996), 43-44. Poll conducted by Smith College's Center for the Study of Social and Political Change, directed by Stanley Rothman.

HOW DO WE 'REPLAN THE JOURNEY?'

# WHAT KIND OF REGULATION?

HANS TIETMEYER

## MAIN CAUSES OF THE GLOBAL ECONOMIC AND FINANCIAL CRISIS

In previous contributions to this and last year's plenary sessions the causes of the global economic and financial crisis – which meanwhile is slowing, but still not fully overcome – were raised and analyzed several times. Last year I wrote an article called 'Globalization and the Present Crisis' in which I pointed to the following five facts as the main causes and amplifiers of the current crisis:

First, progressive opening and internationalization of financial markets as well as marked acceleration of this development through the increased use of new information and communication technologies since the 90s.

Second, erosion of previous national regulations and supervisory rules for financial institutions without the simultaneous development of an appropriate and adequate international regulatory system and efficient international cooperation in the application.

Third, increasing shift of banking activities from the more traditional buy-and-hold approach to an originate-and-distribute concept with certificates and increasing leverage effects. In particular, the escalating securitization and re-securitization often led to growing recklessness in terms of risk control and credit culture in the banks.

Fourth, in addition, amplified use of mark-to-market accounting and the growing practice of publishing results quarterly instead of annually led to increased short-termism and pro-cyclical effects in the financial sector.

Fifth, especially in the years before the outbreak of the crisis serious mistakes in monetary and exchange rate policies by some major industrialized and emerging countries not only led to large imbalances in the external balances, but also to excessive expansion of liquidity in many financial markets.

In addition to macro-policy mistakes, the encroachment of a behaviour skewed towards short-term results and bonuses as well as the insufficient development and application of new and internationally compati-

ble regulations for the supervision of financial institutions were important contributors to the crisis.

Despite recognition of these facts by various international bodies, there are still significant differences among, and even within, countries' approaches towards the actual content, scope, and particularly the necessary enhancement of regulation. This, however, is not surprising given the different traditions and the partially far-reaching consequences of debating new rules for the affected institutions and countries.

## II. INTERNATIONAL INITIATIVES TO ADDRESS REGULATORY GAPS

Already at their first summit in Washington in November 2008, the leaders of the G20 jointly stated: 'Policy-makers, regulatory and supervisors, in some advanced countries, did not adequately appreciate and address the risks building up in financial markets, keep pace with financial innovation, or take into account the systemic ramifications of domestic regulatory actions'.

As early as 2007, the international financial crisis highlighted particular political and regulatory deficiencies in two ways:

First, the increasing openness of borders and the liberalization of international payments and capital raised the question of an international coordination of rules and early cooperation between national supervisors of financial institutions.

The Basel Committee on Banking Supervision, which was established by the central banks of G10 countries in 1974 and in which banking supervisory authorities are also represented, is essentially limited to the development of common guidelines and rules for the supervision of the participating national supervisory authorities of the G10 countries. Although the agreed frameworks, Basel I and Basel II, have also been partially accepted as a guideline by other countries, time frames and details of the application both inside and outside the G10 were often quite different. In particular, the application of Basel II has been delayed in the USA for a long time.

Second, in the past, the Basel framework as well as the monitoring practices of most countries focused primarily on rules monitoring activities of individual institutions only. Systemic problems affecting the stability of the financial system were not always timely and sufficiently taken into account.

In particular, significantly increased importance of systemically important financial institutions, a high degree of national and international integration of the banking industry, herd behaviour of financial intermediaries,

increasing product and marketing innovations in the national and international financial markets and traditional *micro-prudential* supervision of individual banks increasingly require an accompanying *macro-prudential* orientation in order to align to more systemic problems. This was recognised in as early as the spring of 1999, and on my personal recommendation, G7 finance ministers and central bank governors created the so-called Financial Stability Forum (FSF). It had the following triple mandate:

- to help identify incipient vulnerabilities in national and international financial systems. Concerted procedures are needed for a better understanding of systemic risk and to formulate effective financial, regulatory and supervisory policies to mitigate them;
- to improve arrangements necessary to ensure that international rules and standards of best practice are developed and implemented and that gaps in such standards are effectively identified and filled; and
- to ensure that consistent international rules and arrangements apply across all types of significant financial institutions.

The FSF, which includes both the representatives of central banks and supervisory authorities, representatives of governments and relevant international organizations, started its activities with a secretariat at the BIS in Basel before the new millennium. Unfortunately and contrary to my suggestion, under U.S. American pressure, initially it was confined to the G7 countries. Moreover, under Anglo-Saxon influence it was too limited to general discussions and opinions, and also lacked the possibility to promote adequately the development of specific solution concepts.

In light of the current crisis, the G20 summit in London strengthened the previous G7 Financial Stability Forum (FSF) in autumn 2008 and changed it into the G20 Financial Stability Board (FSB).

Thus both membership and task were considerably upgraded, a development which corresponds largely with the original idea for the FSF. It is already perceptible today that the FSB, chaired by Mario Draghi (Banca d'Italia), together with the International Monetary Fund (IMF) represent the principal international promoters and stimulators for the necessary evolution of national and international regulations for the financial sector.

These international efforts for the development and coordination of the control systems are very important – and this is in particular true for common economic, financial and monetary areas, such as in Europe. However, in the world of today and probably also of tomorrow, the responsibility for the practical design and application lies foremost on the national level. In order to avoid dangerous erosion and circumvention through regulatory arbitrage, national regulations and controls should be sufficiently compatible.

### III. CURRENT REFORM AGENDA FOR THE ENHANCEMENT OF THE SUPERVISORY FRAMEWORK

The reform agenda got going in the meantime currently focuses mainly on the further development and extension of the existing prudential rules. Hereby, the primary goal consists of the strengthening of the resilience as well as the limitation of high-risky activities of the regulated financial institutions.

However, it may not be overlooked that the so-called Basel II framework has already intended a row of improvements. Unfortunately, these improvements agreed a long time ago (such as the banning of the use of non-consolidated off-balance-sheet items like so-called special purpose vehicles), have been transferred into national law by several countries only after the outbreak of the crisis, or even not at all.

In addition, on behalf of the G20 summit, some additional enhancements of the regulatory framework are considered by supervisory authorities or are already being implemented. Below are some references about them.

#### *Strengthening the capital base of financial institutions*

Minimum capital requirements have been one of the key elements of the so-called Basel framework for banking supervision for a long time already. However, due to the experiences of the recent crisis, these requirements are intended to be recast and enhanced, at least partially. To enhance the resilience of the financial institutions, banks will be required to hold higher regulatory capital in the future, both in *quantitative* and *qualitative terms*. Hereby, the insertion of countercyclical capital buffers above the minimum requirements is also foreseen. Moreover, the introduction of a so-called systemic risk charge will be considered in order to internalize the positive externality of systemic relevance for the systemically important financial institutions in an appropriate manner (see also chapter V). Stricter capital requirements together with an enhanced coverage of risk exposures could counteract excessive leverage and risky business models of banks. However, to minimize the risk of a credit crunch, especially in the current economic recovery phase, the revision of these minimum requirements has to include an adequate transition period. The preparatory work for the revision of minimum capital requirements is progressing in the meantime. Therefore, a new version of the Basel II rules can be expected by the end of this year.

*Improvement of the coverage of counterparty credit risks*

Being part of the necessary risk control procedures, particularly the capture of so-called OTC derivatives exposure has proven inadequate in many cases. To improve this coverage, it is foreseen to standardize these derivatives as far as possible, to let them trade in the future via thoroughly supervised central counterparties exclusively and to create databases for these transactions (so-called trade repositories) with the aim to provide supervisors with an appropriate information base. Furthermore, the Basel Committee has suggested enhanced minimum capital requirements of trading book exposures (alignment with the banking book) and securitization exposures.

*Restrictions regarding the leverage ratio*

Currently, the mandated working groups are also discussing the question of whether the financial institutions should be obliged to maintain a certain leverage ratio in addition to strengthening their own capital base. Thus, such a rule seems to make sense taking into account the experience of the past. However, its explanatory power and effective leverage-limitation are still debated. In addition to this, rules limiting the leverage ratio have to refer to comparable accounting standards to ensure a level playing field. Therefore, besides the improved coverage of individual exposures, whether or not an overall ceiling on the allowable leverage will be introduced is not yet in sight.

*Development of minimum liquidity requirements*

The recent experiences during the crisis – especially in the context of extensive temporary dysfunction of the money markets – have also shown the urgent need for an adequate provision of liquidity of financial institutions. This will have as consequences, in particular, increased requirements regarding the internal control of the rollover risks, which also has to be checked by improved stress tests. At the same time, control of the so-called systemic liquidity risk that originates endogenously, if, for instance, even fundamentally solvent institutions are forced to liquidate their assets, is part of the consideration. Here, too, a larger liquidity buffer or a reduction in the maturity transformation risks is necessary. Currently, intensive preparatory work is being conducted to determine these minimum standards, which would ensure appropriate liquidity reserves.

*Principles for sound compensation practices*

In recent decades, the practice of an increasingly short-termist remuneration oriented only in profits and particular interests of some bankers and traders and applied in many financial institutions has led to the danger of a bias in risk assessment and short-termism in substantial parts of the business activities of the banks. Therefore, on behalf of the G20 summit, new principles for sound compensation practices have meanwhile been developed by the FSB. Their implementation and application in the G20 countries is currently under review by the FSB in a so-called peer review. On this occasion, the main issue consists of a limitation and longer-term focus of bonus payments to managers and traders.

*Registration and transparency of the activities of credit rating agencies*

In connection with the critical development of single financial institutions and financial products, the activities of credit rating agencies have come under criticism, too. The reproaches have focused mostly on the assessment practices which have been deemed often insufficiently transparent, as well as on the alleged conflicts of interest in the case of advisory activities of rating agencies. Now, after the agencies themselves have published codes of conduct for the future, most countries seem to be satisfied with an official registration of credit rating agency at least temporarily.

*Restriction of proprietary trading by banks*

In particular in the USA, another long-lasting debate has flared up again about the consequences of the repeal of the so-called Glass-Steagall Act which requires the separation of commercial banks and investment banks. In January 2010, President Obama, with reference to Paul Volcker, did not propose a complete return to the former principle of separating banking business, but rather a ban on proprietary trading and own investments in hedge funds or private equity funds for those banks profiting from national deposit guarantee schemes. In this manner, a potential conflict with customer interests should be avoided. Whether and to what extent this so-called 'Volcker-rule' will be binding in future in the USA or even worldwide, is not yet clear. Both in the USA and internationally, intensive controversy is currently in progress.

*Change of provisioning practices*

The aimed correction of a number of individual accounting standards is part of the lessons of the financial crisis. It has appeared that, in particular, the strict market value orientation has considered crisis aggravating. With the objective to give accounting rules a more stabilizing role, the use of, for instance, expected, instead of previously only allowed, incurred losses will be made possible. This transition is likely to have positive forward-looking, earning-smoothing effects and could contribute to stabilize the individual institution and the entire financial system as well.

## IV. MACRO-PRUDENTIAL TASKS OF BANKING SUPERVISION AND REGULATORY POLICIES

One of the main lessons of the crisis is to focus on the systemic dimension of financial stability by means of macro-prudential supervision. Although the discussion about the dimension, nature and measures of the macro-prudential supervision is only in preliminary stage, it must also be continued and brought to some possible concrete common conclusions.

The traditional supervisory approach needs, in particular, a stronger emphasis on systemic views. This also includes the recognition of the fact that maintaining the stability on the individual financial institution level only – which is in the focus of traditional micro-prudential supervision – is insufficient to ensure the sustainable stability of the overall system as well.

Even rational behaviour of individual financial intermediaries may lead – particularly if they act in a similar manner – to contagion and second-round effects at the system level, causing high overall costs. As important as solidity and responsibility (liability) of the single financial institution for the sustainable preservation of a sound financial markets functioning are, the systemic risks are thus not yet sufficiently under control.

Micro- and macro-prudential supervision follow different approaches. Banking supervision looks at the risk factors as widely exogenous risk. It aims to limit the risk exposures of individual financial institutions by single rules (level playing field) to make them as resilient as possible. Linkages with other parts of the financial system are only considered primarily provided that they show immediate risks (in terms of market, credit or counterparty risk) based on contractual relationships. In contrast to this, the macro-prudential supervision gives priority to systemic risks. These are above all those risks which arise from the dynamic interactions within the financial system

itself as well as from feedback effects between financial and real economy. In addition, these risks encompass the varied contagion risks and vicious circles, such as increase of leverage or limited access to liquidity.

Compared to the micro-prudential supervision, in particular to solvency oversight, it is difficult to outline the remit of the macro-prudential regulation precisely *ex ante*. A single financial institution may collapse in the liability-based market economy, whereas a breakdown of the entire financial system by escalating contagion effects must be prevented in the public interest. While micro-prudential regulation shall secure primarily the permanent functioning of individual institutions, the macro-prudential objective of regulation consists, above all, in the permanent preservation of the stability of the financial system. Moreover, for this task, not only are supervisory authorities in charge, but central banks, governments and legislators competent for macroeconomic policy are as well. Sustained financial stability can be achieved only by a consistent combination of a regulatory framework and policy-making, both stability-oriented, whereas the influence of technological and international changes has to be taken into account.

#### V. TREATMENT OF SYSTEMICALLY IMPORTANT BANKS

Beside the appropriate exit or reversal strategy of the very expansionary monetary and fiscal policy designed to overcome the financial crisis, the focus of macro-prudential discussion currently lies on one question: How can the moral hazard problem, which has become obvious after the public bail-out of so called systemically important banks (too-big-to-fail or too-connected-to-fail), be solved in a way that influences the future behaviours of these TBTF institutions?

The public bail-outs of so many systemically important financial institutions during the recent crisis have damaged considerably the personal liability in the financial world as one of the fundamental principles of the market economy. Moreover, the incentive for market participants has been reduced to exercise their disciplinary monitoring-functions over their counterparties.

The so-called Volcker-rule to limit proprietary trading for commercial banks, proposed by President Obama in January 2010, is still highly controversial in public debates and would certainly alleviate this problem, but may solve it insufficient. Obama has therefore also proposed an additional limitation of risk accumulation as well as an additional tax for the largest financial institutions.

In addition to these US-American tax proposals, there are also a number of other proposals and suggestions. They encompass the obligation for large and systemically relevant banks to build up larger capital buffers and/or to establish and finance a joint stabilisation fund (with or without public participation or guarantees) as well as the obligation of these banks to elaborate a so-called 'living will' for an orderly liquidation and the introduction of specific and earmarked taxes. They are already being discussed in some European countries, whereas their concepts range from a transaction tax (Tobin approach) to a functional tax (Pigouvian approach).

The FSB's mandate is to present these and other outstanding issues in October 2010 as joint proposals to the G20 leaders. The current discussions in the expert groups of the FSB deal with a long list of subjects that concern the following issues:

- targeted capital;
- leverage and liquidity requirements;
- improved supervisory approaches;
- simplification of firm structures; and
- strengthened nationwide and cross-border resolution frameworks and changes to financial infrastructure that reduce contagion risks.

This long list of issues makes it clear that there will hardly be simple and generalized solutions for coping with systemic problems that have become obvious during the crisis. On the one hand, the functioning of financial markets may not be jeopardized. On the other hand, privileges for certain financial areas have to be excluded and at the same time negative undesirable trends and dangerous escalations have to be prevented.

## VI. FURTHER DEVELOPMENT OF RULES AND REGULATIONS AS A PERMANENT TASK

At present, the regulatory framework of financial markets is in a dynamic development, both at national levels as well as in international forums. However, we are still far away from a common and internationally viable and future-oriented regulation. In addition to the already elaborated and agreed further developments, which now only have to be implemented, there will no doubt be additional innovations in the coming years. That is the reason for the agreement and implementation of the new regulation to be realized only in a longer process.

Nonetheless, the experiences of the recent crisis have highlighted the importance of national standards as well as their international comparabil-

ity and internal consistency. It is vital above all, that the fundamental orientation must be right. Neither should the principle of liability of capital and management be undermined nor the necessary transparency be compromised. At the same time, an 'over-regulation' endangering the economic efficiency of the financial industry has to be avoided.

Given the international nature of financial markets, beside the substantive orientation of the framework, another key and difficult problem remains to be solved: Although today a large part of the financial activities already takes place internationally, the authority for determining the regulatory framework and its application lies primarily at the national level, and will also do so in the future. Nevertheless, a large part of the supervision today already takes place in so-called supervisory colleges consisting of national authorities responsible for the activities of the respective financial institutions. This cross-border cooperation, which is already well established especially in the EU, is valid for developing it further in the near future and for using it increasingly beyond the EU. Only then can the agreed frameworks be effectively monitored and dangerous contagion effects be prevented.

Only the future will show whether there will also be a move towards joint supervisory authorities, at least in single currency unions, such as in the euro-area. Indeed, a European Systemic Risk Board (ESRB) will be established in the near future in the EU, with a secretariat located at the ECB. Moreover, three European supervisory authorities for banks, insurance and securities markets will be created. Nevertheless, at least so far, also in the EU, the readiness to set up a supranational, last-responsible supervisory authority for financial institutions has not been given yet.

This applies a fortiori to the global level, where there is now hardly a readiness to joint supranational regulations and controls despite the greater willingness of major nations and regions to cooperate in the development of consistent frameworks. This is expected to remain the same for the foreseeable future. In any case, we are certainly still far away from a global financial supervisory authority, and the desire to have one is at least questionable.

Nevertheless, in my opinion, the transformation of the G7 Financial Stability Forum in the G20 Financial Stability Board for the development of common rules is an important achievement. The IMF, consisting of virtually all countries with, however, very different quota shares, would probably be overwhelmed because of the formal decision rules applicable in this task. That is mainly true because the USA almost strictly have a sole veto on account of their high quota share.

Monitoring the implementation of the rules agreed among the G20 could be effectuated probably only by an extensive and neutral transparency of the application practice. In addition to the currently developing practice of so-called peer review by the FSB, in my opinion, the IMF could and should contribute to the monitoring of the implementation of the agreed frameworks. In my view, the IMF could also use its so-called annual 'Article IV – consultations' to check the practical application of the framework agreed by the G20 and to publish its findings in its reports, with no need to change the Articles of Agreement.

Such periodic review and publication would release, in my opinion, useful pressure on effective implementation and enforcement of the agreed frameworks. The latest IMF's internal debate on current and future publication practices of the Fund has shown, however, a certain reluctance to further transparency of the IMF's activities precisely on the part of some representatives of major emerging economies. Obviously, they fear the excessive influence and pressure from the developed countries. Nevertheless, I think the inclusion of the regulations governing financial institutions and a periodic extensive publication of the results would be sensible and useful.

Both the international agreement on an adequate framework as well as the control of its national implementation and application by an appropriate transparency are necessary.

However, there will not be simple nostrums also on this occasion. The process of international cooperation for the rule-making itself as well as for the implementation of the rules is still on a learning curve which must remain open to new and better solutions.

# IS THE GLOBAL AUTHORITY A FEASIBLE SOLUTION?

HERBERT SCHAMBECK

## I.

Das Miteinander der Menschen verlangt Ordnung, und die Ordnung bedarf zu ihrer Begründung die Autorität.

*Der Gehalt des Begriffes Autorität* verdeutlicht sich schon aus der Herkunft vom lateinischen Wort auctoritas und dieses von auctor, das sich vom Zeitwort augere herleiten lässt; dies bedeutet fördern, wachsen, zunehmen und vermehren.

Von augere kommt auch das Wort Auxilium, das in Deutsch Hilfe bedeutet. Eine weitere Ableitung vom augere führt zu dem aus der antiken Geschichte geläufigen Titel Augustus, der zunächst Mehrer und Schöpfer, dann auch erhaben, heilig und anbetungswürdig heißt.

Der *Begriff* der Auctoritas wird *mannigfach verwendet*; in den Schriften des Augustinus kommt er an 1164 Stellen vor.

Gleich den Verschiedenheiten an Ordnungen gibt es *Verschiedenheiten an Erfordernissen und Begründungen von Ordnungen* sowie damit auch an *Autorität*. Von einer solchen Autorität in der Welt und für die Welt hat Papst Benedikt XVI. in seiner Sozialenzyklika „Caritas in veritate“ gesprochen.

In dieser Enzyklika verlangte Papst Benedikt XVI. 2009: „Um die Weltwirtschaft zu steuern, die von der Krise betroffenen Wirtschaften zu sanieren, eine Verschlimmerung der Krise und sich daraus ergebenden Ungleichgewichten vorzubeugen, um eine geeignete vollständige Abrüstung sowie Ernährungssicherheit und Frieden zu verwirklichen, den Umweltschutz zu gewährleisten und Migrationsströme zu verwirklichen, ist das Vorhandensein einer *echten politischen Weltautorität* ... nötig. Eine solche Autorität muss sich dem Recht unterordnen, sich auf konsequente Weise an die Prinzipien der Subsidiarität und Solidarität halten, auf die Verwirklichung des Gemeinwohls hingeeordnet sein, sich für die Verwirklichung einer echten ganzheitlichen menschlichen Entwicklung einsetzen, die sich von den Wer-

ten der Liebe in der Wahrheit inspirieren lässt. Darüber hinaus muss diese Autorität von allen anerkannt sein, über wirksame Macht verfügen, um für jeden Sicherheit, Wahrung der Gerechtigkeit und Achtung der Rechte zu gewährleisten“ (Nr. 67).

*Die Forderung nach Autorität hat in päpstlichen Lehräußerungen eine Tradition: besonders sei auf die Enzyklika „Immortale Dei“ (Nr. 25) Papst Leo XIII. 1885, die Weihnachtsbotschaft 1944 Papst Pius XII. (U-G 3480/3481), die Enzykliken „Pacem in terris“ 1963 Papst Johannes XXIII. (Nr. 46 f.) und „Populorum progressio“ Papst Paul VI. 1967 (Nr. 78) verwiesen. Auch das Kompendium der Soziallehre der Kirche 2004 verlangt „eine im Rahmen der internationalen Gemeinschaft ausgeübte politische Autorität“, sie soll „das Recht befolgen, das Gemeinwohl anstreben und das Subsidiaritätsprinzip achten“ (Nr. 441).*

Dieses Kompendium schließt sich ebenso wie Papst Benedikt XVI. der Forderung des II. Vatikanischen Konzils an, das in der Pastorkonstitution „Gaudium et spes“ im Zusammenhang mit der absoluten Ächtung des Krieges gefordert hat, „dass eine von allen anerkannte öffentliche Weltautorität eingesetzt wird, die über wirksame Macht verfügt, um für alle Sicherheit, Wahrung der Gerechtigkeit und Achtung der Rechte zu gewährleisten“ (Nr. 82).

## II.

*Die Forderung nach einer Weltautorität ist aus dem Streben der Menschen nach einer Ordnung im Rahmen des Möglichen erklärlich. Das beginnt bereits im individuellen Bereich des Menschen, der in der Ich-Du-Beziehung die Entfaltung seiner Persönlichkeit erfährt. Aristoteles hat schon vom Einzelnen als Zoon politikon geschrieben und im 20. Jahrhundert Martin Buber „Die Schriften über das dialogische Prinzip“ verfasst.*

*Auf allen Ebenen des Lebens, und zwar des Individuellen und Sozialen, ist ein Ordnungsstreben gegeben und wird gleichzeitig auch die Unvollkommenheit des Friedens erlebt und die Unerreichbarkeit eines vollkommenen Friedens deutlich.*

Geradezu in klassischer Formulierung betitelte Immanuel Kant sein Werk „Zum ewigen Frieden“. Rückblickend wissen wir aber, dieser ewige Frieden ist unerreichbar und ist auch global nicht möglich. Die Geschichte lehrt uns dies.

Diese Geschichte reicht vom Herrscher, der religiöse und weltliche Macht in der Antike zu vereinen sucht, über das Nebeneinander von Papst und Kai-

ser im Mittelalter mit seinem Streben nach einem universalen christlichen Reich bis zu dem Bemühen im politischen Bereich zu einer weltumspannenden Autorität zu gelangen, wie sie mit dem Völkerbund nach dem Ersten Weltkrieg versucht wurde und mit den Vereinten Nationen nach dem Zweiten Weltkrieg mit ihren Möglichkeiten und Grenzen gegeben ist.

Je umfassender die Ansprüche auf Ordnung sind, desto mehr verdeutlicht sich die *Unterschiedlichkeit* dieser Ansprüche, die sich bisweilen zu Gegensätzlichkeit steigern. Je globaler der Beziehungsbereich ist, umso spannungsvoller werden die Ordnungserfordernisse und das in den Möglichkeiten des Für-, Mit-, Neben- und Gegeneinanders. Jede weltumspannende Organisation, daher auch die UNO, hat mit der Verschiedenheit individueller Einstellungen, persönlicher Wünsche, gesellschaftlicher Interessen, staatlicher Zwecke, vor allem aber auch religiöser Glaubenshaltungen und kultureller Einstellungen zu rechnen.

An Hand dieses aktuellen Beispiels zeigt sich, dass eine *Weltautorität* ein bestimmtes *Ausmaß an Grundkonsens*, basierend auf einer ausreichenden Gemeinsamkeit an Werten und normativer Sicherung im positiven Recht sowohl in der Ordnung der Staaten wie der Völkergemeinschaft, *voraussetzt*.

### III.

*Jede Autorität*, auch die globalbezogene Autorität hat *eine normative und motivierende Seite*. Die normative Seite der Autorität stellt die Begründung einer Rechtsbeziehung gegenüber den einzelnen Normadressaten dar, das kann im Staat eine Einzelperson oder ein Staat selbst in der Völkergemeinschaft sein. Der Ordnungsanspruch der normativen Seite der Autorität ist die positivrechtliche *Geltung*,<sup>1</sup> ihr Bestand hängt von der Wirksamkeit ab, welche wieder von der Rechtsanwendung durch die Normsetzungsorgane und vom Rechtsgehorsam durch die Normadressaten bestimmt wird. Dieser Rechtsgehorsam ist zwar positivrechtlich begründet, in seiner *Wirksamkeit* ist er aber von Bedingungen und Umständen abhängig, welche den positivrechtlichen Bereich übersteigen, wie es Glaubenshaltungen, weltanschauliche Überzeugungen und ideologische Einstellungen sind. Solche Haltungen können auch mögliche konträre sein und führen dann zu dem *Widerstand*, von

<sup>1</sup> Näher Herbert Schambeck, *Ethik und Staat, Schriften zum öffentlichen Recht*, Band 500, Berlin 1986, S. 64 ff.

dem Adolf Merkl, ein Mitbegründer der Wiener Rechtstheoretischen Schule, dessen letzter Assistent ich war, einmal sagte: „Es gibt Zeiten, in denen es ehrenwerter sein kann, durch den Staat, als für den Staat zu sterben“.

Die volle *Anerkennung einer Autorität* verlangt nicht allein die *Akzeptanz* auf deren *normierender*, sondern auch auf der *motivierenden Seite*. Auf diese Weise kann bei einer rechtlich begründeten Autorität *zum Rechtsgehorsam* auch die *Rechtsüberzeugung treten* und so die *Geltung nicht allein eine normative*, sondern *auch eine motivierende* sein.

Die an eine Autorität gestellten Anforderungen sind vielfältig. Papst Benedikt XVI. selbst weist in seiner Sozialenzyklika auf die „*mehrwertige Bedeutung*“ der „*politischen Autorität*“ (Nr. 41) hin.

Aufgrund dieses Hinweises des Papstes auf die „*mehrwertige Bedeutung*“ der politischen Autorität kann angenommen werden, dass er sich der jeweils differenziert gesehenen *Sachbezogenheit der Autorität* bewusst war. Er weist geradezu in seiner Sozialenzyklika in Bezug auf die „*mehrwertige Bedeutung*“ der „*politischen Autorität*“ darauf hin, dass sie auf dem Weg zur Verwirklichung einer neuen sozialverantwortlichen und nach dem Maß des Menschen ausgerichteten, wirtschaftlich-produktiven Ordnung nicht vergessen werden darf (Nr. 41). Er betont auch, dass „eine verteilte und auf verschiedenen Ebenen wirkende politische Autorität gefördert werden“ (Nr. 41) muss und spricht sich bezüglich der zusammengewachsenen Wirtschaft für eine engere Zusammenarbeit der Regierungen aus. Im Zusammenhang mit der erforderlichen internationalen Hilfe „sollte“ sie „gerade im Rahmen eines solidarischen Plans zur Lösung der gegenwärtigen wirtschaftlichen Probleme die Festigung der Verfassungs-, Rechts- und Verwaltungssysteme in den Ländern, die sich dieser Güter noch nicht vollkommen erfreuen, eher fördern“ (Nr. 41).

Papst Benedikt XVI. hat auf „die dem Rechtsstaat eigenen Garantien“ (Nr. 41) hingewiesen, einschließlich der Einhaltung der Menschenrechte und erkennt: „Der Staat muss nicht überall dieselben Ausprägungen haben: die Unterstützung zur Stärkung der schwachen Verfassungssysteme kann auf hervorragende Weise von der Entwicklung anderer politischer Akteure neben dem Staat begleitet werden, die kultureller, sozialer, regionaler und religiöser Art sind“ (Nr. 41).

„Um die wirtschaftliche Globalisierung lenken zu können“, weist Papst Benedikt XVI. auf die *Subsidiarität* hin; sie ist nämlich für „die Gliederung der politischen Autorität auf lokaler Ebene, auf der Ebene der nationalen und internationalen Zivilgesellschaft und auf der Ebene der übernationalen und weltweiten Gemeinschaft ... einer der Hauptwege“ (Nr. 41).

Ergänzend sei hinzugefügt, dass alle diese *Entfaltungen der Autorität auf verschiedenen Ebenen* zu ihrer Wirksamkeit sowohl die normierende wie die motivierende Geltung verlangen. Diese Geltung ist vor allem was ihre motivierende Seite betrifft von der *Entwicklung der Ordnungen* bestimmt; waren diese Ordnungen *früher hierarchische und in Positionen* begründet, so sind diese *in unserer Zeit mehr auch partnerschaftliche* geworden, deren Begründung nicht allein in der Position, sondern in der *Argumentation* grundgelegt ist. In unserer Zeit sind *Autoritäten* notwendig, *die befragbar und der Antwort fähig* sind. Diese auch partnerschaftlich begründbare Autorität verlangt Zeitverständnis.

#### IV.

Dieses *Zeitverständnis zur Autoritäts- und Ordnungsbegründung* ist in einer Entwicklung nicht leicht, in welcher Transparenz auch von Unterschiedlichkeit immer deutlicher und Globalisierung immer stärker werden. Das *Christentum* mit seiner Glaubenslehre und Werteordnung hat sicher *zur Humanisierung von Gesellschaft und Staat* über den Kreis der Kirche hinaus zunächst in Europa und später mehr oder weniger freiwillig angenommen *auch* in der *Völkergemeinschaft beigetragen*. Vor allem die Lehre von den Menschenrechten war dazu wegweisend. Die *Mehrdimensionalität der Menschenrechte*, welche über den Kreis der Christgläubigen der Menschheit zu Gute gekommen ist, hat dies gefördert. Dies wurde auch im letzten Pontifikat in dem bemühten Hinweis auf die *Erfordernisse ökumenischer Brüderlichkeit und sozialer Partnerschaft* durch Papst Johannes Paul II. und jetzt durch Papst Benedikt XVI. fortgesetzt.

In einer *globalisierten Welt* kommt es darauf an, dass alle Beteiligten unter Wahrung ihrer *Identität*, bei Staaten unter *Wahrung* ihrer Souveränität *in freier selbstverantwortender Weise kooperieren*. Grenzüberschreitende Probleme und Aufgaben, wie z.B. das Wachstum der Bevölkerung und der Umweltschutz zählen beispielgebend dazu. Regierungen können auf Grund ihrer verfassungs- und völkerrechtlichen Legitimation auch vertragsrechtlich zusammenwirken; in vielen Bereichen, wie z.B. in Bezug auf die Menschenrechte erweist es sich auch als wertvoll, dass Regierungen und Nichtregierungsorganisationen (sogenannte NGOs) kooperieren. In diesem Fall ist ihre *demokratische Legitimation unterschiedlich* und der *Minderheitenschutz* nicht immer entsprechend gegeben. Daneben gibt es auch Schwierigkeiten und Problemstellungen mit weltweiten Organisationen, also solchen, die eine globale Bedeutung

haben, wie z.B. die *UNO*, in der einzelne Staaten als Großmächte ein Vetorecht haben und die keine obligatorische Gerichtsbarkeit kennt. Auch die *UNO* kann daher ihrer Aufgabe zur friedlichen Beilegung internationaler Streitigkeiten und zur *Friedenssicherung* durch kollektive Sicherheitsmaßnahmen nur *unvollkommen* nachkommen. So haben auch die USA 2003 den *Irakkrieg* ohne Autorisierung durch den Sicherheitsrat der *UNO* und entgegen den Mahnungen Papst Johannes Paul II. begonnen; Ähnliches bis Gleiches gilt bezogen auf Papst Paul VI. und den Vietnamkrieg und schon vorher für Papst Pius X. und Papst Benedikt XV. betreffend den Ersten Weltkrieg und Papst Pius XII. in Bezug auf den Zweiten Weltkrieg.

Noch viele weitere Stimmen ließen sich zitieren, etwa in Bezug auf den Irakkrieg, den die in unserer Akademie bestens bekannten früheren Präsidenten des Päpstlichen Rates „Iustitia et Pax“ Roger Kardinal Etchegaray und Renato Kardinal Martino auch verurteilt haben, ein Krieg, als dessen Folge es den Christen in dieser Region allgemein und den Katholiken im besonderen mit schwersten Verlusten katastrophal ergeht! In diesem Zusammenhang sei auch daran erinnert, was schon am 23. März 2003 der damalige Präfekt der Glaubenskongregation Joseph Kardinal Ratzinger in einem RAI-Interview sagte, nämlich es dürfe der *Namen Gottes* nicht verwendet werden, „um Gewalt zu rechtfertigen“. Er fand diesen Sprachgebrauch „traurig“ und nahm damit auf die sowohl in Washington als auch in Bagdad betriebene Inanspruchnahme des göttlichen Willens für eigene Ziele Bezug. Kardinal Ratzinger erklärte damals im Pontifikat Papst Johannes Paul II.: „Der Papst hat so oft betont, dass Gewalt niemals im Namen Gottes angewendet werden darf. Denn Gott ist die Versöhnung und der Garant des Friedens. Wir müssen Gott als den sehen, der uns vereint und nicht als den, der trennt und die Gewalt rechtfertigt“.<sup>2</sup>

Auf Gott ist aber Bezug zu nehmen im Zusammenhang mit den Menschenrechten!

<sup>2</sup> Kathpress, Wien 23.3.2003, S. 1 f.

## V.

Diese Menschenrechte sind Inhalt der *UNO-Menschenrechtsdeklaration*, die alle Mitglieder der UNO anerkannt haben. Sie *könnten* eine *Basis für eine weltautoritative Bedeutung der UNO sein*. Trotz dieser allgemeinen Anerkennung erleben wir aber die Missachtung dieser Menschenrechte unter anderem auch durch die Volksrepublik China und die Russische Föderation. Auch im Verhältnis zu den USA, die mit Europa an sich die gleiche Wertebasis teilen, hat sich – etwa am Beispiel der Diskussion zu Guantanamo unter der früheren US Administration oder in der Frage der Todesstrafe – gezeigt, dass es auf beiden Seiten des Atlantik in der Frage des Schutzes der Menschenrechte manchmal substantielle Auffassungsunterschiede gibt; diese dürfen aber nie vergessen lassen, was die Welt so viel den USA sonst an Vorbild in der Entwicklung zum demokratischen Verfassungsstaat<sup>3</sup> durch mehr als zwei Jahrhunderte und im 20. Jahrhundert Entscheidendes zur Bewältigung zweier Weltkriege sowie nach 1945 durch Jahrzehnte in der Konfrontation mit dem Kommunismus zur Sicherung der Demokratie und Freiheit zu danken hat.

Neben der in manchen Fällen fehlenden und zumindest mangelnden ausreichenden Beachtung der Menschenrechte gibt es auch solche der *Außerachtlassung* der zu deren Schutz gegründeten internationalen Einrichtungen, wie z.B. des *internationalen Strafgerichtshofes*. Das Statut dieses Gerichtshofes wurde von bedeutenden, weil mächtigen Staaten wie China, Indien und den USA gar nicht erst ratifiziert. Dazu haben die USA sogar 35 Staaten die militärische Unterstützung entzogen, die sich weigerten, ein Abkommen zu unterzeichnen, in dem sie sich verpflichten, US-Bürger, die wegen Kriegsverbrechen oder Verbrechen gegen die Menschlichkeit angeklagt sind, an die USA zu überstellen und nicht an den Internationalen Strafgerichtshof.

Leider muss man daher feststellen, dass *gleich dem Völkerbund* nach dem Ersten Weltkrieg die *UNO* nach dem Zweiten Weltkrieg *nicht immer ausreichend die globale Autorität* geworden ist, die weltweit Ordnung schafft und sichert. Besonders zeigte sich dies u.a. während des Jugoslawienkrieges, in Ruanda und Osttimor.

Auf die meisten globalen Herausforderungen unserer Zeit wie den Klimawandel, die internationale Kriminalität und den internationalen Dro-

<sup>3</sup> Siehe *Dokumente zur Geschichte der Vereinigten Staaten von Amerika*, hrsg. von Herbert Schambeck, Helmut Widder und Marcus Bergmann, 2. Aufl., Berlin 2007.

genhandel kann es nur eine globale Antwort geben – und hier gibt es *zu den Vereinten Nationen als universelles Forum keine brauchbare Alternative*. Im Angesicht großer humanitärer Katastrophen wie zuletzt in Haiti ist die UNO ein unverzichtbarer Koordinator für internationale Hilfeleistungen. Außerdem ist der Sicherheitsrat der Vereinten Nationen die einzige internationale Instanz, die nach dem Völkerrecht berechtigt ist, militärische Zwangsmaßnahmen zur Aufrechterhaltung des Friedens und der internationalen Sicherheit zu beschließen. Natürlich ist die UNO in Konfliktsituationen immer wieder blockiert; dies liegt aber nicht notwendigerweise an der Handlungsschwäche der Organisation als solcher, sondern am mangelnden Willen ihrer Mitglieder, vor allem der fünf Vetomächte des Sicherheitsrates, in Krisensituationen an einem Strang zu ziehen. Andererseits sorgen sich UNO-Blauhelme gerade auch in jenen Konfliktregionen, die (wie der vielgeprüfte afrikanische Kontinent) nicht immer im Fokus der Weltpolitik stehen, oft unter schwierigsten Bedingungen und unbedankt um den Schutz vieler Menschen, vor allem von Frauen und Kindern, die von Tod, Gewalt, Hunger und Vertreibung bedroht sind.

*Trotz dieser erwiesenen Mängel im internationalen Rechtssystem, die immer wieder in Konfliktsituationen offenkundig werden, bedarf es der Anerkennung weltweiter Verantwortung für eine globale Humanität.* Diese hat auch Papst Benedikt XVI. in seiner Sozialenzyklika mit seiner Forderung nach einer echten politischen Weltautorität gemeint. Für diese sollten sich in einem Für- und Miteinander die Staaten Kontinente übergreifend einsetzen. Die UNO war und ist eine solche Autorität. Papst Benedikt XVI. hatte schon am 18. April 2008 in seiner Rede vor der UNO betont, dass sie „ein privilegierter Ort“ ist, „an dem die Kirche bemüht ist, ihre über Jahrhunderte zwischen den Völkern aller Rassen und Kulturen entwickelte Erfahrung ‚der Menschlichkeit‘ einzubringen und sie allen Mitgliedern der internationalen Gemeinschaft zur Verfügung zu stellen“. In diesem Zusammenhang sei auch nicht vergessen, dass zur gleichen Zeit, als sich die Souveränität der Staaten entwickelte auch in der katholischen Völkerrechtslehre Francisco De Vitoria am Übergang vom 15. zum 16. Jahrhundert die Lehre vom *Weltgemeinwohl*, dem *bonum commune humanitatis*, entwickelte.

Die UNO mit ihren Spezialorganisationen, aber auch Staatenverbände wie z.B. die Europäische Union, die von kontinentaler Bedeutung sind, können in einem Für- und Miteinander zu diesem Weltgemeinwohl beitragen, und eine weltweite Autorität zum Tragenbringen, die dem Recht dient. So hat auch Österreich die Rechtsstaatlichkeit („Rule of Law“) zu

einem der Themenschwerpunkte seiner Arbeit im Sicherheitsrat gemacht und schon im Rahmen seiner Bewerbung um einen Sicherheitsratssitz eine von vielen sehr positiv beurteilte *Initiative zu „The Rule of Law and the UN-Security Council“* gesetzt. Kernaussage dieser Arbeiten, die auch mit zentrales Anliegen Österreichs als Mitglied und vorsitzführendes Land im Sicherheitsrat ist, ist, dass auch der *Sicherheitsrat selbst an die Grundsätze der Rechtsstaatlichkeit gebunden* ist. Dies spielt insbesondere auch in der Beurteilung von Sanktionsverfahren des Sicherheitsrates eine wichtige Rolle! Das Recht hat nämlich auch eine Mittlerfunktion und die Menschheit verschiedene Optionen!

Hans-Dietrich Genscher hat es vor kurzem in Rom gesagt: „Wir stehen heute als Menschheit vor drei Optionen: Das eine ist die Chaos-Option, wenn wir alles laufen lassen, wie es läuft. Wohin das führt, haben wir bei der Finanzkrise schmerzlich erfahren müssen. Das andere ist die Vorherrschaftsoption, das ist der Irrtum, die Annahme, dass ein Land stark genug sei, allen anderen vorzugeben, was zu tun und was zu unterlassen ist. Und schließlich die Kooperation, die wir in Europa aus geschichtlicher Erfahrung gelernt haben. Ja, Europa kann ein Beispiel geben, nämlich dass man aus der Geschichte lernen kann ... Das ist das Erfolgsgeheimnis der europäischen Einigung“.<sup>4</sup>

Auch in diesem Zusammenhang hat bereits Erzbischof Roland Minnerath in seiner „Ethik in Zeiten der Globalisierung“ gegen den Verfall des Sozialen für eine Weltinstanz, „welche die Zusammenarbeit zwischen den Staaten regulieren soll“, vier Kriterien genannt: „sie muss an strikte Rechtsnormen gebunden sein – unter Wahrung des Subsidiaritätsprinzips, mit klaren Kompetenzgrenzen und unter demokratischer Kontrolle im Gleichgewicht der Mächte und Verantwortlichkeiten“.<sup>5</sup>

Eine solche rechtlich er- und gefasste *Autorität ist in globaler Dimension aber nur möglich, bei wechselseitiger Akzeptanz* von Kulturen und Religionen begleitet von allgemein anerkannten Grundwerten des privaten und öffentlichen Lebens sowie Grundrechten. Dieses Ziel wird nicht immer und überall von allen erkannt und anerkannt. Aber so, wie der Frieden angestrebt, aber nicht immer auf Dauer erreicht wird, sollte diese Idee

<sup>4</sup> *L'Osservatore Romano*, Wochenausgabe in deutscher Sprache, 19. März 2010, Nr. 11, S. 12.

<sup>5</sup> Roland Minnerath, *Gegen den Verfall des Sozialen, Ethik in Zeiten der Globalisierung*, Freiburg-Basel-Wien 2007, S. 119.

von einer *Weltautorität als Motivationsgrund die Politik begleiten* und das nicht nur durch die Repräsentanten der Politik, sondern *möglichst von vielen*, wenn nicht allen im öffentlichen Leben. Bischof Egon Kapellari hat über diese Wege von Ideen treffend gesagt und damit will ich schließen: „Viele Wege führen durch die Landschaft des menschlichen Lebens. Es sind Reisewege, auf denen man sich physisch von einem Ort zu einem anderen bewegt, oder auch nur Denkwege, die ohne Ortsveränderung begangen werden“.<sup>6</sup> Gedanken über Global Authority sind solche Denkwege, welche die Menschheit in ihrer Entwicklung voranbringen können.

<sup>6</sup> Egon Kapellari, *Begegnungen unterwegs, eine Nachlese*. Graz 2003, S. 9.

## COMMENTARY ON HANS TIETMEYER AND HERBERT SCHAMBECK

ROCCO BUTTIGLIONE

If I were to indicate the common ground of the lectures of our colleagues Tietmeyer and Schambeck I would point out the concept of *Ordnungsliberalismus*, a liberal attitude that is however conscious of the relation obtaining between liberty and truth. Liberty does not exist in a void but in a concrete situation and must be exercised within this context and respecting the nature of the things constituting this context. This is particularly relevant when the objects of the action of human liberty are other human beings who can never be reduced to mere objects of the action but must always be considered at the same time as subjects, who also exercise and must be made able to exercise their own freedom. The conviction of the absolute value of each human person engenders here an ethics of the consequences. That is an ethics of responsibility led by the principle of the respect for the human person. There is an order, dependent on the nature of things and on the nature of the person, that offers the context within which the liberty of the person has to be exercised and which the person has to respect in her choices and in her actions. These principles apply to the market as well as to all other spheres of social action. Here the consequence has to be drawn that the market is not an absence of rules but rather a specific rule of behaviour. A functioning market excludes both violence and cheating.

Adam Smith (so often quoted but not always carefully read) knew that very well. He knows the invisible hand of the market, but he also knows the visible hand of the state that sets the rules of the market in order to make it subservient to the common good. There are also moral and religious presuppositions of a functioning market. For example the two commandments of God: *thou shalt not steal* and *thou shalt not lie*.

The paper of Mr. Tietmeyer deals mainly with 'thou shalt not lie'. One of the roots of the present crisis and perhaps the main root of the financial crisis is that the commandment 'thou shalt not lie' was not upheld by responsi-

ble individuals and was not adequately reinforced by appropriate regulations. On the contrary existing regulations were weakened or even altogether erased.

A whole market of financial commodities has arisen out of the control of the regulating authorities. Instead of carefully evaluating the merit of the credit many bankers gave money under conditions that made improbable the repayment of the loans and, instead of setting aside reserves to compensate for the possible failure to repay the loans, sold the doubtful credit to the public. The risk was divided with other operators. This strategy worked until it was used by a limited number of financial operators. When it became commonplace the market was inundated with bad debt and it collapsed. Moreover some financial operators bought collateral guarantees against the possible failure of the credit certificates they had issued and sold. They were not covering their own risk but rather making a wager on the risk of others. All this could happen because regulations were weak and because international financial operations take place in a space that is not adequately controlled by any public authority. Here we find the link between the paper of Mr. Tietmeyer and that of Mr. Schambeck: do we stand in need of a global governance? It is easy to answer: up to a certain extent yes. The financial markets cannot be regulated by national authorities alone. We stand in need not only of increased cooperation between national banks and of better coordination of the legislation of the different states. We also need a certain measure of international institutions to overview international markets in order to protect the customer of financial commodities but also in order to protect the whole human community against the consequences of irresponsible behaviour on the international market. It goes without saying that we also need to strengthen the common authorities within the European Union and even more within the euro area. Here we have clearly a task for which individual state authorities are inadequate and here therefore the creation or the strengthening of a European authority would be justified according to the principle of subsidiarity.

We do not want to impose upon all financial operators high moral standards, we only want to restrain an excessive measure of vice that is detrimental to all and incompatible with the good functioning of the markets.

Now allow me please to enlarge the focus of this reflection. Are financial markets the only area in which we stand in need of a global authority? I think there are other instance in which such an authority is desirable. The international agreements on tariffs and trade have created a world market of commodities. We have all reaped the advantages of this market in terms of better quality and lower prices. This globalization has also had undesir-

able consequences. The balance of power between capital and labour has been altered in favour of capital. If they deem it to be advantageous companies can move their productions to countries where wages are extremely low and labour rights are thoroughly ignored. We have a competition on the market of labour with rights (free labour) and labour without rights (slave labour). This is unfair and detrimental to the interest and rights of workers both in the developed and undeveloped countries. Perhaps we stand in need of a General Agreement on Wages and Labour to offer minimal protection to the rights of workers throughout the world. It is a matter of fact that in many countries today there is no labour market. You have a market where two free subjects bargain between themselves until they reach an agreement. Where one of these subject is absolutely weaker than the other there you have no bargain and no market but the imposition of the interests of the stronger through the sheer weight of force. I am conscious, of course, of the delicate nature of this issue. It is better to be exploited by the market than to be excluded from the market, and therefore the regulations adopted must be flexible in order not to hinder the entrance in the world market of new countries and new subjects whose only chance is the low cost of their labour. We need however to control the process and to progressively upgrade the level of protection of workers in the global economy.

Here we are not considering a world government but, according to the principle of subsidiarity, authorities and institutions of a world governance that respond to demands national governments are unfit to cope with. The WTO has established itself as one such authority and I do not see why on a similar basis an authority for the supervision of world financial markets or for the protection of the rights of labour should not be established.

Are there other areas where a similar demand for international governance may be detected? Perhaps there are many. Let me mention just one of them. The non proliferation of nuclear weapons lies in the common interest of mankind and it would be advantageous for all to strengthen the powers of the existing agency supervising the compliance with the norms contained in the non proliferation treaty. A new treaty could be envisaged, more binding and extending its scope also to the cooperation against non member states attempting to build nuclear weapons. I shall not deal in this context with the needed reform of the United Nations and of the Security Council but there is a widespread conviction that such a reform is badly needed.

Let me now say a few words on some specifically European problems. Many countries of the European Union have a common currency but no common economic policies. The current crisis has brought to evidence the

inadequacy of this state of affairs. Some fixed parameters substitute in theory the missing common European policies. Under normal circumstances this may work (more or less). In front of a severe shock all parameters become untenable and we do not have adequate instruments to determine a common European response. Now it seems that under the pressure of circumstances we are moving in the right direction. The budget laws of each state will be examined by the council of financial ministers before being proposed for approval to national parliaments. I hope that this means we will have a reasonable determination of the aggregate European deficit spending. This will allow us to have more effective anticyclical and full employment policies. We need them. In all of our countries unemployment has been growing. It is not only a consequence of the financial crisis. It also depends upon the new world division of labour that makes it impossible to keep low technology productions in Europe. The difference in wages is so large that labour-intensive productions move toward the emerging countries. This process need not be a zero sum game. It may be advantageous for all under condition that we create here in Europe some millions of new jobs in technologically-advanced sectors, in the so-called economy of knowledge. We have known this for a long time. We have developed the so-called Lissabon project and the Lissabon process just in order to implement the corresponding policies. As a matter of fact these policies were not implemented because the method chosen (the so-called open coordination method) did not work. We need to allocate resources for these policies in order to make them effective.

Where can we find these resources? In the present state of our finances I can see only two sources.

The first one is a moderate and responsible reconsideration of Keynesian policies. Keynesian policies have fallen in discredit for two reasons. Irresponsible politicians used them to justify unbearable current expense deficits with the purpose of stimulating the demand and they presuppose a level of sovereignty that has been lost with globalization. When I suggest a reconsideration of Keynesian policies I do not propose to go back to the excesses of the past. Deficit spending is not justified by the purpose of supporting a lagging demand (this may be a side effect). Its purpose must be to support the competitiveness of Europe as such through investments in material and immaterial infrastructure according to the broad outline of the Lissabon process. These investments could be entrusted to the member states' authorities or could be effected directly by the European Union. There is not much Keynesianism in this. It is the old 'golden rule' that differ-

entiate also in classical economy between current expenses and investment expenses. It was proposed also in the elaboration of the Maastricht treaty but was refused mainly because of a lack of reciprocal confidence. Today perhaps we should strengthen the controls in order to prevent member states from cheating but should also show more confidence in the common project. If the common project is controlled directly by the Union it will perhaps be easier to display the needed amount of confidence. Appropriate resources should be allowed to the Union for the service of the debt and Eurobonds should be emitted and allocated. In this case the rules of Maastricht for member states should be tightened: there would be no need to allow a deficit threshold of 3%, and a balanced budget could be the rule. Or a limited amount of deficit spending could be allowed under circumstance to counteract asymmetric shocks while symmetric shocks like the one we are going through should fall in the direct responsibility of the Union.

The second cause for the aging of Keynesian policies is, as I have already mentioned, the fact that in a global economy the demand stimulus produced by deficit spending is low. Workers hired through government programs will spend a large percentage of their money in foreign goods and services and the return for the national economy will be low. In our case the main purpose is not to support the demand but to make the system more competitive. We can add that a very large part of European foreign commerce takes place between member states. The stimulus effect that would be lost in merely national Keynesian policies is largely preserved if these policies are European based.

Another source of revenue to finance a program for infrastructure and job creation could come from a tax on bank transaction. A very low tax would go practically unnoticed by the vast majority of customers but would be a formidable obstacle to speculation and reduce its extent and its force. It would also generate a very significant amount of resources to be invested to create jobs and boost the economy. Speculation bears the main responsibility for the crisis but, up to now, it has not been called to contribute to the efforts to mend its effects and overcome it. This proposal has a double advantage. It puts some of the burden on those who caused the crisis (and often also profited from it) and it helps to bring back the financial system to its true vocation and purpose, that is to allocate resources to enterprise and labour in order to support human life and create jobs and welfare for all. Of course this measure can be taken only with a broad consent, otherwise it would only have the effect to divert speculative capital from countries that introduce this rule to countries that do not. One might wonder if in this case a purely European basis would be sufficient or if we would stand in need of an agreement with all other major economic powers.

## THE CRISIS AND ITS AFTERMATH FROM THE POINT OF VIEW OF THE DEVELOPING COUNTRIES

JUAN J. LLACH

'Crisis? Oh, yes! I have heard there is something like that in the USA and Europe. Here we somehow have less work, that's all'. Had many people in China or India been asked about the most serious crisis since the Great Depression they would very probably have answered in such a way. They didn't need to see Table 1 to know this, because they have kept improving their living standards during the last three years, only a bit less than in the last few of decades. Table 1 gives reasons to them. By the end of 2010, GDP per capita will have grown since 2007 at an annual rate of 8.8% in China, 5.4% in India and 2.4% in the rest of Developing Asia. GDP per capita growth will be also positive for the majority of emerging countries (EC)<sup>1</sup> by the end of this year. For instance, African countries will end 2010 with an average GDP per capita growth of 1.4% per year during the last four years, what is faster than their historical performance.

Even more amazing is that total GDP gains of EC between 2007 and 2010 (US\$ 4.08 trillion) will largely surpass DC's losses (US\$ 0.21 trillion), resulting in a world GDP growth of 3.87 trillion. Even taking into account a shorter period (2007-2009, not shown in Table 1), world GDP increased by 1.23 trillion dollars, as EC gains of 2.41 trillion more than offset DC's losses of 1.18 trillion.

This argument does not imply to deny the negative effects of the crisis on EC and their people, very well documented in Dasgupta (2010). But the fact is that in spite of these damages both (gross) welfare measures, GDP and GDP per capita have been positive since 2007 for 5.1 billion people or 77.7% of the world population. In sharp contrast, predominant discourses

<sup>1</sup> Most of the developing countries are beginning to emerge, so I will call them emerging countries (EC) from now onwards. We didn't use this name in the title of the paper because its current use is limited to the most successful or bigger developing countries.

Table 1. THE OTHER INEQUALITY – GROWTH BY GROUPS OF COUNTRIES, 2007-2010

	GDP pc $\Delta\%$	GDP pc annual rate	$\Delta$ Total GDP US\$ Trill.	% of Total US\$ Trill. Growth	World Pop. %
<b>World</b>	<b>2.1</b>	<b>0.7</b>	<b>3.87</b>	<b>100</b>	<b>100</b>
<b>Developed, E. Europe ,CIS</b>	<b>-2.0</b>	<b>-0.7</b>	<b>-0.21</b>	<b>-5.4</b>	<b>22.3</b>
<b>Emerging</b>	<b>12.9</b>	<b>4.1</b>	<b>4.08</b>	<b>105.4</b>	<b>77.7</b>
-Sub Saharan Africa	4.2	1.4	0.20	5.2	12.9
-North Africa & Middle East	5.6	2.2	0.29	7.5	5.0
-LATAM and Caribbean	2.0	0.7	0.33	8.5	8.6
-Developing Asia	20.5	6.4	3.31	85.6	51.3
o/w China	28.7	8.8	2.24	57.9	19.6
o/w India	17.1	5.4	0.70	18.1	17.1
o/w Others	7.6	2.5	0.37	9.6	14.5

Source: Author's estimates based on World Bank data. Note: partial sums may not coincide due to round off.

in Japan or in the West referred to the same period have been limited to its dramatic effects in developed countries (DC).<sup>2</sup> This is natural, because if everything goes well, they will recover their pre-crisis GDP per capita only in 2012. What is not natural, instead, is that the subject of those discourses is 'the world', just when we are beginning to live a historical, civilization-wide change, i.e., the new role of EC under Asian leadership. They are now stronger than before the crisis, and everything indicates that they will remain at the centre of the global economy for a very long time, opening new life opportunities to 5600 million people,<sup>3</sup> almost 85 percent of the world population.<sup>4</sup> After analyzing this phenomenon in the first part of the paper, we discuss in the second part what changes in the architecture of the world economy would be needed to get, at the same time, the continuity and improvement of the development of EC as well as the recovery of the DC.

<sup>2</sup> An interesting exception is Checki (2009).

<sup>3</sup> In this case we include CIS's and Eastern Europe's populations in the EC's total.

<sup>4</sup> In Table 1, 77.7% excludes CIS's and Eastern Europe's populations.

## 1. THE NEW STAGE OF THE GLOBAL ECONOMY AND THE EMERGING POWER

1.1. *Emerging countries, stronger than ever*

Alter the worst world economic crisis since 1929 – the first really global one – the world economy is very clearly beginning to recover, slowly in DC and very rapidly in the EC, particularly in Asia.<sup>5</sup> This is one of the many evidences of the megatrend of the new role of EC that is now in the process of reinforcing itself and will have deep, mainly positive consequences all over the world.<sup>6</sup> As it can be seen in Table 2, EC will continue increasing their share in the global GDP from 25% before the crisis to 35% in 2020 in current US\$, and from 41.9% to 54.9% in PPP US\$ (purchasing power parity), a more relevant measure from the point of view of internal welfare. More impressive yet is EC's share in world GDP growth. After surpassing 100% between 2007 and 2010, because of the drop in DC's GDP, from now onwards that share will reach more than 55% in current US\$ and 75% in PPP US\$. EC' resiliency to confront the global crisis has been noteworthy, and geographically widespread and uneven at the same time. Less than half of them dropped in a recession in 2009 (62/150, 41.3%). North Africa and the

Table 2. DC AND EC SHARES IN GLOBAL GDP AND GDP GROWTH

	Global GDP's share (%)			
	Developed countries		Emerging countries	
	US\$	US\$ PPP	US\$	US\$ PPP
2007	75.1	58.1	24.9	41.9
2008	74.1	56.8	25.9	43.2
2009	73.2	55.6	26.8	44.4
2010	72.5	54.6	27.5	45.4
2015	68.4	49.9	31.6	50.1
2020	64.4	45.1	35.6	54.9
	Global GDP growth share (%)			
2007-10	-70.0	-19.3	170	119.4
2010-15	46.6	24.8	55.4	75.2
2015-20	39.8	23.4	60.2	76.6

Source: author's elaboration on IMF and World Bank data.

<sup>5</sup> As anticipated in PASS (Juan J. Llach, editor, 2008).

<sup>6</sup> See J.J. Llach and M. Marcela Harriague (2009); *The Economist*, December 30th, 2009.

Middle East was the best performer (3/20, 15%), followed by Sub-Saharan Africa (10/44, 22.7%), and then Developing Asia (10/26, 38.5%). The worst performers were the countries of the Commonwealth of Independent States (7/13, 54%), LATAM and the Caribbean (20/32, 62.5%)<sup>7</sup> and Central and Eastern Europe (12/15, 80.0%). In sharp contrast, only three out of thirty-three DC – Australia, Israel and Korea – escaped from a recession in 2009.

## 1.2. *Explanations of emerging countries development and new role*

It is possible to identify at least five factors to explain this new megatrend of increasing EC's prominence. All of them have good probabilities to be long lasting, so it is also very probable that this new megatrend has arrived to remain with us for a long time.

1. *'Unlimited' supply of labor at constant initial wages.* A central key of EC's development model – particularly noteworthy in Asia – is that, given the low labor *market* productivity in the agricultural sector, a continued rural-urban migration process takes place. Once they arrive, migrant workers offer their labor in the cities at constant wages, higher than in the agricultural sector but lower than their urban marginal productivity, giving their contractors the opportunity to make more than 'normal' benefits. This is the model developed more than half a century ago by Nobel Prize-winner W. Arthur Lewis (1954). Given the international mobility of capital and the growing supply of new technologies, conditions are thus created to a sustained growth of investments in those EC characterized by the Lewisian model. China, India and other Asian countries are very clear examples, but this process is also taking place in Latin America and Africa. As it can be seen in Graphs 1 and 2 (see pp. 605-6), both agricultural employment and rural population are still very abundant in Asian countries – 60% in China and 70% in India in the case of rural population – which implies that the Lewisian model can continue working for two more decades, at least.

Lewisian model poses per se serious challenges and even threats to manufactures in other parts of the world, particularly in DC, because it is not only based on low wages but also on artificially depreciated exchange rates, as it is briefly analyzed in the second part of the paper.

<sup>7</sup> Even when LATAM has improved its performance during the last couple of decades, it has also continued losing positions in the world rankings (Izquierdo and Talvi, 2010).

2. *Terms of trade appreciation and wide match-up margins.* Half a century ago Raúl Prebisch and Hans Singer presented the *EC's terms of trade deterioration* hypothesis. According to it, raw materials or commodities' prices secularly tended to lose value in terms of industrial goods, and this trend was an invincible impediment to the economic growth of commodities' producing countries. Both demand and supply factors coincided to cause of this trend. On the one hand, the demand for industrial goods normally grew more rapidly than that of commodities. On the other hand, commodities markets tended to be competitive, while industrial markets tended to be oligopolic or monopolic. Although controversial from the empirical point of view most of the evidence shows that since the crisis of 1929 and the Second World War, commodities prices were effectively weak. In the case of food, it is very probable that the protectionist policies enforced by DC since the postwar period played a relevant role in this process, as they reduced the size of food world markets.

The situation has changed since the beginning of this century. Just to give a couple of examples, the price of a notebook computer in 2000 was 20 tons of soybeans, and nowadays is just 2 tons, i.e., ten times cheaper. In the year 2000 1 ton of soybeans could buy 1 mobile phone, and nowadays it can buy 25 mobile phones, i.e., 25 times more. If you put either oil, copper, cotton or corn instead of soybeans, this amazing change in relative prices is similar. So what we are experiencing nowadays is a process of *EC's terms of trade appreciation*. Their immediate causes are twofold, an increase in the nominal prices of commodities and a continuous drop in the price of industrial goods, particularly intense for technological goods coming from IT or biotechnologies. But which are the explanations of this relative prices movement? On the one hand, the increase of commodities prices is basically due to the growth and the growing importance of Asia, a continent whose natural resource endowments are very poor compared to those of Africa or South America. On the other hand, the price of technological or capital goods goes down because they are produced by ever lower-wage workers in more and more competitive markets. It is very probable that these two factors will tend to remain with us for a long time, and this appreciation of its terms of trade gives wide margins of productivity increase and catch-up to commodities-producers in EC.

The case of mobile phones is particularly amazing. As shown in Graph 3, the world stock of mobile phones jumped from 800 million in 2000 to 4 billion in 2008, to 4.6 billion in 2009 and to more than 5 billion in 2010 (not shown in the Graph). In the case of EC, the increase was from 200 million

in 2000 to 3.2 billion in 2009, while in DC the growth was from 600 million to 1.4 billion. A mobile phone is more and more not only a way to talk person to person, but a connection to the world. In few more years most mobile phones will be computer-like, but they are already helping very poor people in cities as well as in the countryside to increase their productivity and their income. For instance, they allow poor farmers to know weather forecasts and market conditions, and they also allow many people to learn to read and write, because they need these abilities to have access to the cheapest communication device, i.e., mobile phone text messages.<sup>8</sup> Analogous processes are taking place with computers and, to a lesser extent, with biotechnologies (Graph 3, see p. 607).

3. *Increased and improved investment in education.* A growing number of EC are investing more and better in education, and their enrollments are gradually converging to those of DC (J.J. Llach, PASS, 2005). East Asian countries lead international education assessments in which they participate (like OECD-PISA). Chinese, Korean and Indian students are the biggest populations among foreign students in US universities and, together with the Taiwanese, they are the fastest growing ones too. Every year 700,000 people in China and 350,000 in India get an engineering degree, compared to 70,000 in the USA. This implies that the engineers/population ratio is growing faster in these Asian countries than in the US (Li *et al.*, 2008).

4. *Two thirds of the world population are improving their consumption patterns and getting out of poverty.* Urbanization, productivity growth and increased education obviously lead to an acceleration of consumption growth. Since 2007, consumption increases in China and India contributed more than that of the US to world GDP growth. McKinsey (2006) forecasts that in the next 20 years most Chinese people will leave poverty: the percentage of those living with less than US\$ 285 per month will fall from 77% to 2.5%. Chinese middle classes will have 78% of urban income in 2016, from 42% in 2006, and the richest will increase their share from 0.1% to 19.4% of urban income. In 2025 Chinese cities will be one of the biggest world markets, with a consumption of US\$ 3 trillion, more than the current Japanese

<sup>8</sup> See *The Economist* (9/25/09 and 1/7/2010) and A. Goyal (2010). Babajob (Bangalore, India) and Soukel (Palestine) offer job search services through msn. In Kenya, M-Pesa offers different forms of electronic payments through mobile phones. In Moldova and Iran they helped organize demonstrations against authoritarian governments, and in India they help people vote and check election results.

consumption. A similar story can be told of India. McKinsey (2007) forecasts that in twenty more years India will be the fifth world consumption market, jumping from US\$ 370 billion to 1.5 trillion, and middle classes there will jump from 50 to 583 million people.<sup>9</sup>

Table 3. ESCAPING FROM POVERTY – NON-POOR PEOPLE IN EC, 1990-2005

**Table 3: Living between \$2 a day and \$13 a day**

Region	Number living between \$2 and \$13 per day (millions)		Change 1990-2005 (millions)	Percent of total change	Percent of the population	
	1990	2005			1990	2005
East Asia and Pacific	315.5	1117.1	801.6	65.9	19.8	59.3
Of which China	173.7	806.0	632.3	57.0	15.3	61.8
Eastern Europe and Central Asia	355.3	347.8	-7.5	-0.6	76.3	73.4
Latin America and Caribbean	276.7	362.1	85.4	7.0	63.2	65.0
Middle East and North Africa	170.2	240.1	69.9	5.7	75.5	78.7
South Asia	192.7	380.2	187.5	15.4	17.2	25.8
Of which India	146.8	263.7	116.9	9.6	17.3	24.1
Sub-Saharan Africa	117.7	197.1	79.4	6.5	22.8	25.8
Total	1428.1	2644.3	1216.2	100.0	32.7	48.5
Total excluding China	1254.4	1838.3	583.9	48.0	38.9	44.3

Source: M. Ravallion, (World Bank, 2009).

Changes in consumption patterns can be observed not only in China or India, but also in Africa and Latin America. Between 2000 and 2010 Africa GDP per capita has grown at 2.62% per year, almost twice the level of Latin America (1.37%), the fastest in African modern history<sup>10</sup> and in sharp contrast with an annual drop of 0.2% from 1980 to 2000. Table 3 shows that non-poor people in EC increased from 1.428 billion in 1990 to 2.644 billion in 2005. Around half of this growth came from China.

5. *Better economic policies.* It is very evident that EC's economic policies have significantly improved from the times of the previous commodities bonanza in the early seventies of the last century, when most of them used to be oriented to a closed economy, huge government interventions,

<sup>9</sup> See also A. Panagariya (2008).

<sup>10</sup> The previous record was from 1960 to 1970 (2.35%).

twin deficits (fiscal and external), high inflation and chronic indebtedness problems. During the last decades, instead, most of them practice good macroeconomics – twin surpluses or equilibrium, administered floating exchange rates and low inflation – and good microeconomics as well, as it can be seen in market-friendly policies and competition to attract foreign and domestic investments. Some cases are particularly noteworthy. Peru's President, Alan García, was also president 25 years ago. But his current economic policies have completely changed, adapting them to what most ECD currently do. As a result, Peru is very clearly the economic star of LATAM in this century. Most of us also have vivid memories of the Vietnam war. Although it still has – like China – an authoritarian single-party political regime, Vietnam has left behind its past of cruel devastation and has become one of the main factories of the world and one of the most successful economies. These EC's economic policies have not been positive only as regards EC's growth. They also lead their financial assets to be the least risky worldwide (Graph 4, p. 608) and, what is more important, they have allowed them to enforce very strong anti-cyclical, Keynesian-oriented policies to successfully fight against the world crisis.

### 1.3. *EC's growth megatrend in the very long run*

Such is the strength of the aforementioned EC's growth megatrend that it could even evolve into forecasts like the ones made by Nobel Prize-winner Robert Fogel (2007 and 2009), shown in Table 4. According to him, in 2040 China, India and parts of SE Asia would have 63.6% of world GDP, almost three times the 22% level they had in 2000. The whole group of EC would increase their participation from 49.1% to 80%. Surprisingly, LATAM would have in 2040 a bigger total GDP than Europe and similar to the sum of Europe and Japan. EC, in contrast, would increase their share from 49.1% in 2000 to 80% in 2040. A bit incredibly, LATAM's share in world GDP would be equivalent to the sum of Europe and Japan (Table 4, p. 604).

Of course, lots of assumptions and potential mistakes underlie these projections. Just seeing the magnitude of current environmental problems in China or India it is almost impossible to think of China and India with a total GDP of US\$ 160 trillion in 2040, almost four times the world GDP in 2000. Other relevant questions also arise. Could such a change in the distribution of economic powers between different civilizations be as peaceful as was the transfer from the UK to the US? Notwithstanding these deep doubts, there are good pieces of evidence to believe that the trend described

by Fogel is basically right.<sup>11</sup> The world has begun a one-way, civilization-wide change process through which the axis of the world's economic power is constantly moving from the Atlantic to the Pacific. Some people in the Far East think that this is nothing else but a return to the normal state of world affairs, the same as it had been from 2000 BC onwards, and that the last seven or eight centuries of Western hegemony (1200 to 2000) were just an exception.

#### 1.4. *Impacts on commodities*

There are at least five ways through which EC's growth megatrend, and particularly that of Asia, has impacted on commodities demand and prices.

a) *Direct consumption effect.* While Asia has a relative scarcity of natural resources per person, Africa and South America have the opposite factors endowment. So Asia is and will be a growing net importer of natural resource-based goods. This is an obvious channel of positive influence of Asian growth on commodities markets and commodity-producer countries.

b) *Producer countries' consumption effect.* The positive impact of Asian demand on African and South American growth also has, in turn, a positive impact on their consumption through a sort of foreign trade multiplier. So Asia's impact on EC growth is twofold, through higher commodities prices and/or bigger commodities markets and through a foreign trade multiplier. The most notorious case is that of Africa, as shown in Graph 5 (see p. 609).

c) *Environmental limits effects.* Most Asian countries, and particularly China and India, have serious environmental problems that, among many other effects, put ceilings to increasing agricultural production at the pace of the growth in demand.<sup>12</sup> Of course, this situation could eventually change in the future with the help of (unpredictable) new agricultural technologies, as was the case with the Green Revolution in the sixties and GMOs since the nineties of the last century.

d) *Oil and biofuels effect.* As is very well known, the increase in energy prices in this century is at least partially explained by the growth of EC's

<sup>11</sup> Just think of this data: from January 2006 through December 2009, industrial production in Asia grew 56% and that of the US dropped by over 10%.

<sup>12</sup> See Lester Brown, in [www.earthpolicy.org](http://www.earthpolicy.org). A non pessimistic vision of China's environmental situation can be read in Dean and Lovely (2008).

demand. As a consequence, many countries that are net energy importers have significantly augmented their biofuels production. The clearest case is ethanol production in the US. Although very doubtful from the point of view of their net environmental effects and food price increases, the fact is that this substitution creates additional demand for grains.

*e) World economy current adjustment: wages and consumption increases in EC.* The fifth transmission channel has deserved scarce attention, but it is probably the most important regarding future developments. As a consequence of this first really global crisis, Asian countries are learning that excessive reliance on an export-led growth model has its faults. The main one is that it creates equally excessive dependence on events out of their own control. This is more evident for countries like China or India, whose domestic markets are as big as they are underdeveloped and whose exports and investment aggregate demand shares look exaggerated. For these reasons it is very probable that in the years to come they will gradually change their growth drivers, increasing the role of consumption at the expense of exports and investment. This change would not be very positive only for Asian countries, but for the whole world as well. It is beyond any doubt that monster balances of payment imbalances – particularly US deficit and the surpluses of Asia and oil-producing countries – have played a relevant role in the origin of the world crisis, as they provided the ultimate source of liquidity afterwards recycled through very risky financial conduits. For these reasons, in order to help prevent or moderate a next world financial bubble it is crucial to have more equilibrated balances of payments in the years to come.

These processes will imply an appreciation of Asian currencies and an increase of Asian wages in dollar terms. The first one is not only important from the point of view of macro balances but also in order to keep world economy open to trade. If it does not take place, retaliations from countries in other continents will very probably take place, damaging world economy. As regards Asian wages, their increase in dollar terms will be very positive for wage-earners all around the continent as well as for all the countries that sell goods and services to Asia, reinforcing in that way the EC's growth megatrend we are describing.

### 1.5. *Less poverty, better income distribution*

The aforementioned long run trends have had very clear positive effects in reducing poverty and improving income distribution (Sala-i-Martin, 2006). Asian stories are very well known. But the same is going on in Africa,

the continent in which 75% of the poorest of the world live on less than US\$ 1 per day. Sala i Martin and Pinkovski (2010) show that African poverty is falling in such a way that if present trends continue, the poverty-related Millennium Development Goal of halving the proportion of people with incomes less than one dollar a day will be achieved on time. African poverty reduction is remarkably general: it cannot be explained by a large country, or even by a single set of countries possessing some beneficial geographical or historical characteristic. Additionally, the growth acceleration that began in 1995 decreased African income inequality. The obvious fact that the global crisis has seriously damaged the living standards of many poor people in EC should not make us forget that the continuity and improvement of their growth patterns will allow millions of people to leave poverty in the years to come. A clear example of these patterns is the improvement of drinking water access shown in Graph 6 (see p. 610).

### 1.6. *The scandal of hunger*

Of course, not everything is rosy in ECs. Not only because of the dramatic life patterns of the EC's megalopolis in which billions live, from polluted environment to crime and high incidence of drugs, but also because the economic crisis has had very negative impacts on those already struggling to survive (Dasgupta, 2010). Besides, the number of chronically hungry people in the world rose from 913 million in 2008 to 1.02 billion in 2009, almost a sixth of the global population (FAO). Food prices that are 17% higher than they were two years ago, and big shortfalls in remittances and investment are contributing to growing hunger. The economic slump has meant a growing share of the world's population is going hungry, after a steady decline since 1970. And FAO notes that global food output will have to increase by 70% to feed a population projected at 9.1 billion in 2050. Sixty-three percent of this increase will come from Asia, and 26% from Africa.

## 2. ARE THESE DEVELOPMENTS SUSTAINABLE? STRUCTURAL AND WORLD GOVERNANCE ISSUES

Now it's time to ask. Is this megatrend of EC's rapid development and increasing importance in the world economy sustainable? Which conditions would make it lasting? What are their relationships with DC developments?

### 2.1. *Connectedness*

It is very evident that the world economy's connectedness increases every year. Just to mention one example, world exports doubled in volume from 1989 to 2000 and grew 50% from 2000 to 2008. In such a context, although EC have an incredible growth dynamics it still significantly depends on DC growth. Take for instance balances of payments. At world level they are equal to zero – we don't yet trade with other planets or stars. One's surpluses are another's deficits, and given the export-led growth model that prevails in most of Asia and the Middle East it is very relevant to remember this point. Both of them need DC's demand for their products to grow fast, and this in turn requires the economic growth of DC. Another relevant case of connectedness is that if the current recovery of the world economy were to imply, as in the last cycle, ever increasing Asian and Middle East surpluses and US deficits, there will be similar risks of a new crisis. As we have already mentioned, balance of payments disequilibria have been the raw material without which it would have been impossible to issue the enormous amount of risky financial assets whose explosion was the detonator of the crisis.

### 2.2. *New structural forces*

Balance of payments disequilibria have some deep, structural forces behind them. On the one hand, there are factors that contribute to an EC's structural balance of payments surplus. The Lewisian model plus the high proportion of rural population in countries like China and India keep under control Asian wages and the prices of the goods so produced, pushing Asia's exports permanently up. Additionally, Asian growth impulses the exports of commodity-producing countries, giving way to balance of payments surpluses in many other EC.

This structural trend toward EC's exports growth could be from now onwards counterbalanced by forces operating the other way in DC. Japan and Europe appear to be pursuing the impossible triad of no kids, no immigrants and good pensions. As it was shown in Table 4, Japan's population is projected to fall 15% between 2000 and 2040, and European population will remain stable in the same period. This leads to low savings and investments, to unsustainable fiscal balances – the demographic pyramid makes it impossible to finance current pensions – and to a general lack of the social and economic dynamism you can see in countries with younger pop-

ulations, plenty of projects and confident in the future. In the case of Europe, economic inequalities between countries inside the euro zone are nowadays very evident and cast doubts on its competitiveness in the long run. The situation in the US is somewhat different, as they are more open to immigration and more prone to scientific and technological developments. It is true that there are many differences among DC, but in a large majority of them the next decade will be characterized by heavy fiscal burden and slow economic growth. And it will be very difficult for them to resume growth at the same rates they enjoyed before the crisis.

### *2.3. The risk of a negative adjustment*

It is probable that, as a result of the aforementioned trends, the world economy will negatively adjust its imbalances in the years to come. Both EC's growth and balances of payments surpluses could be limited by a slower DC growth. This would be negative not only from the social point of view, given DC's high rates of unemployment, but from the fiscal situation too. In a slow growth context it will be much more difficult to reduce unemployment and to fix the unsustainable fiscal deficits and the burden of the public debt.

### *2.4. The potential role of improved world governance*

April 2009's G20 London summit created new hopes of a badly needed improvement in world governance. Coordinated credit credentials were given in such a way to countries and banks that financial markets strongly recovered. Together with monetary and fiscal policies previously enforced by many countries – although in a less coordinated way – those signals were decisive to give way to the very clear current recovery of the world economy. By the way, it's strange how many Keynesian economists, together with many others, who advocated these kinds of measures, have been so far very skeptical about the recovery, predicting an imminent new crisis that never arrives.

Unfortunately, the hopes of improved world governance have gradually begun to erode. The clearest case is financial regulation in which enough progress has neither been enforced at the country level nor at the world level (Tietmeyer, 2010). Another very relevant case is all that is going on around Greece, of course not just a Greek issue, but a European one. An eventual Greece default would create very serious problems for many other countries in Europe, perhaps not only in the Mediterranean or the Baltic, but in other unsuspected places too.

In order to allow a sustainable growth of both EC and DC, deep changes in current processes and policies would be necessary. All of them look difficult per se and even more improbable in the absence of better world governance.

1. *Fixing exchange rate misalignments.* In order to preserve their export-led growth model, many Asian countries have been reluctant to allow the market-driven appreciation of their currencies. At variance with what normally happens, the Lewisian structure of their labor markets allows them to perform this policy without an inflation risk. However, this is not good for the world equilibrium as it favors permanent and sometimes increasing balance of payments surpluses.

2. *Less poverty and better income distribution in EC, particularly in Asia.* Asia's exchange rate policies lead to lower wages in dollar terms. On the contrary, a more accommodative exchange rate management would increase wages in dollars and would also lead to a bigger share of consumption in aggregate demand. Of course, this would also imply a gradual change from a pure export-led growth model to a combined consumption-plus-export-led growth. This would be good not only from the point of view of world economy equilibrium and growth, but for the reduction of poverty and the improvement in income distribution in Asia as well.

3. *New demographic, immigration or pension system policies, particularly in Western Europe and Japan.* Without a population-prone change in their demographic and/or immigration policies both Europe and Japan seem to have no destiny but one of slow growth, serious fiscal and indebtedness problems and social conflicts on pension systems. A reform of the pensions systems could play an analogous role, but social resistances to it is very intense (A.H. Boersch-Supan and A. Ludwig, 2010; C. Horioka, 2009).

4. *New and coordinated financial regulation.* As Sinn (2010) and Tietmeyer (2010) argued in this same session, without a rapid, new and sound coordinated financial regulation, the risk of a new deep world crisis is very high.

### 3. CONCLUSIONS: NEW VALUES AND BEHAVIORS OR PLAYING DICE ONCE AGAIN

It is improbable and for sure uncertain that the aforementioned policies or something similar to them will appear endogenously or spontaneously. As a matter of fact, it has not happened up to now. Better world governance, instead, would make more probable the enforcement of policies like 1 and 4, with positive effects on 2. But this is not endogenous either. The world

appears now in a very different vein of no-lateralism, after leaving behind one of would-be unilateralism and a weakening of multilateralism. True, there are some positive signals, such as the unexpected central role of the G20 as the most important forum to discuss global economic policies. But everything appears light, in tune with the times, and there are so many Gs that it is very difficult to understand each one's role. It is true that G2, the six-monthly meeting between China and the US, is the most powerful forum. But none of them appear to have enough capacity to reach understandings, much less to enforce them.

Marx believed that, when productive forces were developing in such a way that production relationships were not functional to them, a change in such relationships would take place. He first thought of this change as something endogenous but afterwards changed his mind and reached the conclusion that changing capitalist production relationships required a conscious and deliberate action of the proletariat. We all know how cruel, and at the end unsuccessful, the socialist revolutions so inspired turned out to be. Now we are in a situation in which the development of productive forces is in conflict with national and even supranational regional governments. Perhaps it is not clear up to what point it would be convenient for humankind to definitively surpass national or regional sovereignties. But the conflict is there, and if new forms of world governance do not develop, the economic results will be some sort of slow down of the development of EC and of the recovery of DC and an increased risk of a new world crisis.<sup>13</sup>

We are probably experiencing an even deeper conflict between capitalist development at a planetary scale and postmodern values and culture. It seems clear, at least, that in order to get a sustainable and less crisis-prone development, values and behaviors not abundant in postmodern societies are needed. They are justice, intergenerational solidarity and an active subsidiarity both at the national and international levels. It is not clear what leaderships or institutions will have a clear and loud enough voice to induce these new values and behaviors. The Social Doctrine of the Church has consistently insisted on their importance and it is one of the best endowed to fulfill more clearly and firmly this role in the near future.

<sup>13</sup> Of course, the lack of good world governance is having, and perhaps will have even more in the future, very negative effects on geopolitical and environmental issues. Their analysis is far beyond the reach of this paper.

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# THE GOVERNANCE OF GLOBALIZATION: GLOBAL POLITICAL AUTHORITY, SOLIDARITY AND SUBSIDIARITY

VITTORIO POSSENTI

The 2010 Plenary Session is devoted to the crisis in the global economy and tries to assess, in the light of the Church's Social Doctrine and especially of the encyclical *Caritas in Veritate*, the current situation, the impact of the crisis on people, communities and institutions, and the corrections to be made at all levels. My speech will develop around the nuclei indicated in the title, and do not be amazed if I am forced by the 'thing itself' to introduce in my paper categories that are currently marginal or absent in the social sciences and in political thought.

One of my assumptions is that the era of ideologies has not ended with the collapse of communism: some ideologies are still alive, and they falsify the reality. Perhaps the fundamental aim of my paper is to acquire knowledge which could reduce risks of wrong actions or of wrong non-actions. Many things go wrong because we do not have a sufficient knowledge of social phenomena, which are in themselves very complex.

## A MULTIPLE CRISIS OF GOVERNANCE

1. The problem of the governance of globalization became urgent at the moment in which its process started: it began slowly in the seventeenth and eighteenth century and became powerful in the second half of the twentieth. By governance I mean the whole of the functions of government and control, authority and direction, decisions and purposes that it is necessary to exercise in the political, economic, legal, social and communicative fields, for the achievement of a positive outcome, and of an equitable allocation of public goods. There cannot be such an outcome, and therefore a global com-

mon good, without a multiple and stratified governance from the bottom up, which aims at achieving global institutions and solidarity between ‘foreigners’ – foreigners because of culture and civilization – capable of recognizing and including the other. Humanity now forms a community of destiny.

The problem we are facing is the most fundamental and ancient of all the political problems, namely to ‘invent’ political institutions for human groups which have none and yet need them, with the aggravating circumstance that today these groups are the whole human family.

2. The issue of governance must now be addressed in a context, which has been deteriorated by a multiple crisis, which has proceeded from the financial and economic system, but which cannot be reduced to these areas only and that manifests itself as a social, cultural and moral one. It is a crisis in the global economy that is manifested mainly in it, but which does not only come from economics. Benedict XVI focused on the ethical and cultural roots of the crisis in his *Message for World Peace Day 2009* (Fighting poverty to build peace), and *Caritas in Veritate* (see in particular n. 65), about the failures of ‘unscrupulous finance’.<sup>1</sup>

The multiple crisis that undermines the foundations of a free and just society and involves the three main areas of each society (socio-economic, political and cultural-axiological) includes:

– A heavy *defect of governance* on behalf of the global institutions, primarily but not exclusively economic, which were not able to keep up and often failed. One result has been an incredible destruction of wealth. If global economic governance was capable of facing up to the task, political governance did not fare better. Systemic disorder remains very high. With respect to globalization, it seems that it is the risks and negative repercussions which are globalized, much less the benefits. Consequently, many require a strengthening of the international authorities responsible for global financial regulation and control.

– A *crisis of capitalism*, which became manifest in the vehement and dangerous transition from an industrial capitalism to a purely financial one, based on greed and blind to systemic risks: this is a transformation that can change for the worse the very nature of capitalism.<sup>2</sup> Indeed

<sup>1</sup> Of great importance is the reaffirmation of a full right to food and water, maintained in § 27.

<sup>2</sup> I think that people (among them I place myself) are right who, arguing that capitalism comes from *caput*, underline that the fundamental capital is the intellect. Mind is the primary source of wealth of nations: inventive mind and practical intelligence as bad

abstract financial transactions have replaced human relations and a wise risk assessment. And the market itself, which is not an abstract mechanism but an institution and a place for relations, is in urgent need of rules.

Such a crisis has materialized into a real lust for wealth, fuelled by speculation and irrational financial betting, in a ruthless desire for rapid enrichment. Global finance turned out to be based on very short-term rationales, almost exclusively aimed at maximizing the value increase of the activities themselves, indifferent to aspects that are not the speculative ones and unconnected with any consideration of the common good. We should investigate the violations of basic ethical standards of fairness and justice which have taken place in the process of economic globalization, the lies that were told to the detriment of savings accounts and the thefts perpetrated.

Finance cannot be an independent and crazy variable, nor can it separate work and wealth, implying that the latter does not result from work but from speculative and financial activities. On the disasters caused by a concentration of wealth in the hands of very few people, who are often not owners but depositaries and administrators of borrowed capital, see the lines of Pius XI in *Quadragesimo Anno*, which are still eloquent.<sup>3</sup> The eco-

ethics can divert to the worst of the most important discoveries of the mind (on these issues see V. Possenti, *Oltre l'illuminismo. Il messaggio sociale cristiano*, Ed. Paoline, Cinisello Balsamo 1992, ch. V, 'Presupposti antropologici dei sistemi economici'). Having said this, I add that the collapse of the Berlin Wall and the end of communism did not produce those positive results that could be expected. The opening of the market has favored the wealthy nations, expanding the gap between wealth and poverty, economic globalization has failed to remedy the scandal of poverty, hunger and thirst, and the injustice of the strong on the weak. We are far from a more equitable distribution of goods, while an exasperated utilitarianism continues to guide the choices that lead to alter the environment and to waste resources.

<sup>3</sup> 'In the first place, 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. This dictatorship is being most forcibly exercised by those who, since they hold the money and completely control it, control credit also and rule the lending of money. Hence they regulate the flow, so to speak, of the life-blood whereby the entire economic system lives, and have so firmly in their grasp the soul, as it were, of economic life that no one can breathe against their will. ... And as to international relations, two different streams have issued from the one fountain-head: On the one hand, economic nationalism or even economic imperialism; on the other, a no less deadly and accursed internationalism of finance or international imperialism whose country is where profit is', Pius XI, *Quadragesimo Anno*, nn. 105-109.

conomic crisis fueled by a type of finance that is not linked to any rule other than greed (*auri sacra fames*), highlighted a strong resurgence of the privatization of public goods. In any case the serious damage resulting from deregulation and *laissez-faire* policies, which began in the Anglo-Saxon countries in the 80s and later spread to the West, came out. With deregulation, the economic sector and even more the financial one were made increasingly independent of democracy and politics, with the formation of oligopolistic financial mergers.

– A *cultural crisis*, in which the negative weight of anthropological and moral models of behavior emerged: with respect to the former, I would like to point out the figure of *homo oeconomicus* guided by self-interest, and with respect to the latter the reference to a strongly utilitarian ethics and to an instrumental rationality.

It is naive to believe that the era of ideologies ended with the collapse of communism. The ideology of scientism and, in the economic and political field, that of neoliberalism, which in the last forty years has experienced a surprising revival in the West, are still going strong. Neoliberalism, which stakes only on market, is a form of materialism: it considers as essential reality only the economic goods and attaches a primordial value to the market, which becomes the benchmark for everything else. The *laissez-faire* ideology has convinced companies and states to practice ever more the primacy of the market and of the freedom of exchange. It has influenced the actors' behaviour, leading them to consider many goods as mere commodities with the related idea that anything can be bought.

This was coupled with the systematic underestimation of an ethics of virtue in the market and in economic behavior, i.e. of the civic virtues of trust, loyalty, and moral integrity, capacity for healthy relationships with each other. Economics is and remains a human science that can never marry a neutral axiology, and it is futile to rely on a real development without honest men.<sup>4</sup>

– A *crisis of justice*. It is obvious but often forgotten that an efficient economic system that produces high quantities of goods can at the same time also be unfair in their allocation. Development aid has strongly diminished and on the world scene the poor are left with very few representatives that speak on their behalf.

<sup>4</sup> It's a fact that in the pseudo-global world of today and tomorrow different ethics of economics (and diverse anthropologies) will continue to exist, in opposition and even in conflict, with the possibility that their competition can delete the moral appraisal in economic decisions, or create a relativistic attitude, in the sense that the lack of ethics pushes towards the multiplicity and equal legitimacy of moral options.

## POLITICAL GLOBALIZATION

3. Within the problem of globalization as a multilevel process that concerns the economy, technology, law, politics and its institutions, the most decisive and at the same time the most lacking area is *political globalization* and the *structure of authority* and of the *public powers at global level*. I will give particular importance to this issue, not only for its decisiveness, but also for the delay and lack of analysis in which it is left: indeed the analytical elaborations and attention given to economic and sociological issues are more frequent and accurate than those which address political ones. More generally it is a matter of giving back to the political responsibility and to the reality of politics that objective weight that has sometimes remained latent or less developed in the recent Church's Social Teaching, perhaps for the prevalence of other more markedly economic and sociological languages. Now these can be the bases to develop important theories and practices on the state-market nexus and its shortcomings, much less on many other fundamental political phenomena: peace-war, human rights and duties, common good, environmental, bioethical and biopolitical matters, etc. And it is the reality itself of the world situation which imperiously invites us to reclaim the domain of politics.

*Caritas in Veritate* (CV) recaptures, so to speak, the political issue, devoting some considerations to it, which are not very lengthy but are absolutely relevant as far as the issues they address. CV incorporates the powerful conceptual structure of *Pacem in Terris*, updating its specific references about 50 years later. Published in 1963, John XXIII's encyclical will be fifty years old in 2013: the fact that CV returns to it brings with it the hope that a major document might be issued on its anniversary. In a way, the messages for the *World Days of Peace*, which have been taking place since 1969, have traced its path.

The references to PT and its update are particularly evident in § 67 of the CV. The current crisis, which many have felt almost exclusively as financial, has deep roots in politics and in the related institutions. The big global problems have many names: poverty, war, arms race, energy and environmental crisis, mass migration, genocide, serious situations of injustice and violations of human rights. It is unthinkable that the solution of such a bundle of global problems can be found without a grand project leading to a global political authority: 'there is urgent need of a true world political authority, as my predecessor Blessed John XXIII indicated some years ago, and organized according to subsidiarity. Such an authority would need to be regulat-

ed by law, to observe consistently the principles of subsidiarity and solidarity, to seek to establish the common good' (CV, n. 67). An organization, which oversteps but does not cancel the level of the state, is necessary on the basis of the existence of a universal common good which cannot be ensured by a fragmented political responsibility. In this decisive field *Caritas in Veritate* applies the criterion of tradition that is evolving in new contexts, raising and recovering the precious acquisitions of *Pacem in Terris*.

According to John XXIII's encyclical, 'the rulers of individual nations, being all on an equal footing, largely fail in their efforts to achieve this, however much they multiply their meetings and their endeavors to discover more fitting instruments of justice. And this is no reflection on their sincerity and enterprise. It is merely that their authority is not sufficiently influential', because of the unbridgeable difference between the current political organization and the objective requirements of the universal common good. The new, global problems cannot be adequately addressed and solved unless they are addressed by political authorities that have a breadth, structure and means of the same proportions and capable of operating efficiently on a global scale (see n. 137). Consequently the moral order itself demands the establishment of some such general form of public authority.

Note that PT's analysis is not only concerned with the tragedy of war and the establishment of perpetual peace (Kant 1795, Maritain 1951), but turns to the common good of the human family and to the safeguarding of the dignity of every human being.

There is a fundamental and perennial task that concerns the whole human family and is summed up in the safeguarding of the rights of each and all: this goal was put into concrete form for the first time in human history in the *Universal Declaration of Human Rights* (1948), the *Magna Charta* of international law on human rights and of the world political authority.

4. Within three years (1963-65) John XXIII with *Pacem in Terris*, Paul VI with his 1964 address to the UN and the Council with *Gaudium et Spes*, speaking with one voice on the political key, laid the foundations for a post-modern political philosophy, of which modern thought for centuries remained free even in its most enlightened representatives, while its prevailing line (Machiavelli, Hobbes, Rousseau, Hegel, etc.) went in the opposite direction. Now Benedict XVI reiterates this essential theme in CV. About 15 years before the *Pacem in Terris* J. Maritain with *Man and the State* had paved the way by establishing the need for a global political authority that did not limit itself to a UN reform, which is certainly necessary but flawed by the simple but radical fact that the UN is an association of sovereign

states which do not renounce their sovereignty on the most essential points: for example they want to guarantee themselves at all costs the alleged right to declare war. However precious, the UN's work cannot get to the root of evil, and inevitably remains precarious, because it is a body created and set in motion by the states, of which it can only record the decisions (especially of the most powerful ones). The most formidable obstacle that prevents the resolution of the great problems of the human family is the lack of political organization in the world which, by perpetuating international anarchy and irresponsibility, makes vain many projects for improvement. In the absence of that political organization, we should certainly appeal to multilateralism, although we should be aware of its inherent limitations.

Giving proof of realism, CV lists a number of fundamental matters that should be managed by such an authority: the governance of the global economy; full disarmament, food security and peace; the safeguarding of the environment and the regulation of migrations. Single States are no longer able to exercise their sovereignty over all these fields: the new situation requires the building of sites of integration of responsibilities and decisions: European Union, G8, G20, etc. Of course the world authority called for by the Church's Social Doctrine would need to be legitimated from the bottom up and this is lacking today in several international bodies.

5. *World political authority and the common good.* Happily the Church's Social Doctrine does not follow the 'libertarian' path, which when taken to the extreme leads to anarchy of a civil society that builds itself by autopoiesis, and proceeds without any real function of authority. Recalling the value of the person and of the intermediate social formations between individual and state, this teaching goes beyond the scope of the state-market relations, within which some would like to confine the social dialectic. It inserts a more fundamental level of reality: that of the link between common good and authority. Indeed, the Church's Social Doctrine reacts to that demonization and accusation against authority, which largely afflicts the social sciences and public sphere, and that makes us blind to reality, interpreted through the blinkers of ideology. Yet authority is omnipresent, and its concept is one of the foremost in theological and political thought: Leo XIII recalled it in 1885, even before *Rerum Novarum*, with the encyclical *Immortale Dei*.<sup>5</sup>

<sup>5</sup> Some developments on authority can be found in the following books or essays of mine: *L'azione umana. Morale, politica e Stato in J. Maritain*, Città Nuova, Roma 2003; *L'uomo postmoderno. Tecnica religione politica*, Marietti, Milano 2009; *Solidarity and Sub-*

There is no doubt that the notions of authority and common good are among the most controversial and harassed by the political thought of the last half-century. Looking at the first, at least three objections must be overcome to return to use the term, and fortunately the Church's Social Doctrine has enough courage not to be intimidated by the headwind: the invisible hand tends to make superfluous the task of the political authority; authority is disastrously assimilated to illegitimate power. The third objection is more hidden and 'theological' or better antitheological, and concerns the rejection of the father and of paternal authority, in which the opponents see a repercussion or a reflection of the divine authority. The concept of authority has to deal with the attitude of secularism that seeks to dissolve all theological traces to arrive at an immanent political doctrine without transcendence. Therefore the (a)theological reasons for the crisis of the concept of authority should also be explored.

6. After these hints at the problem of authority, which deserves wider development, the question that counts should be raised: for what purpose and why does the international political reality itself force us to address the problem of a world political authority? It is a dream or a need? For a long time the more conscious political thought has developed the idea of a world political authority to overcome independent state sovereignties and the solution of the war problem, which arises from the clash between sovereign states. According to L. Robbins, 'The ultimate condition that gives rise to those clashes of national economic interests which lead to international war, is the existence of independent national sovereignties. Not capitalism, but the anarchic political organization of the world is the main evil of our civilization...the existence of independent sovereign states should be rightly regarded as the fundamental cause of conflict'.<sup>6</sup> According to Robbins, therefore, the political anarchy of the world inevitably leads to conflicts between sovereignties and to war as an irrational way of resolving disputes. His diagnosis is acute and valid today as yesterday, but is no longer suffi-

sidiarity in International Relations, in AA.VV., *Pursuing the Common Good: How Solidarity and Subsidiarity Can Work Together, The Proceedings of the 16th Plenary Session of the Pontifical Academy of Social Sciences*, Vatican City, 2008, pp. 637-640.

<sup>6</sup> L. Robbins, *The Economic Causes of War* (1940, Italian transl., Einaudi, Torino 1944, pp. 95 and 100). In *I diritti umani oggi* (Laterza 2005) A. Cassese presents the international community as anarchic, 'As long as states do not drastically limit their sovereignty, until we are not able to establish a centralized authority (but operating according to democratic rules), there will be no certainty to ensure a minimum universal respect for human dignity', p. 233f.

cient: the overcoming of the organization of the world based solely on sovereign states is imposed not only by the removal of war, but by the existence of those purposes that concern everyone and by the need to pursue the global goals. Avoiding this, politics would fail and a long series of counterfinalities would have to be suffered: hunger, chaos, destruction, injustice, and continuous violations of the human person. A global political authority is necessary in principle to govern globalization, not only to remove war.

Its need emerges from the very theme of the common good, which has now reached a global dimension. Its theme was neglected for decades by political thought, except in the personalistic and humanistic one, and now re-emerges as unavoidable. Its most meaningful personalistic, communitarian and 'perfectionistic' formulation can be found in *Gaudium and Spes*: 'The common good, that is, the sum of those conditions of social life which allow social groups and their individual members relatively thorough and ready access to their own fulfillment'. The text echoes the formulation of the encyclical *Mater et Magistra* of John XXIII, according to which the common good is 'all those social conditions which favor the full development of human personality'.<sup>7</sup> So the single man as well as social groupings can be defined by a goal, an achievement, i.e. a 'perfection', by an improved and higher implementation of themselves (please note that 'perfection' does not designate only an axiological and moral characteristic, but also an ontological one: development and a good and achieved life). With reference to the concept of perfection, the discourse on the common good is no longer just the prerogative of the social sciences, but invites philosophy and theology to join it.

A similar approach is found in CV, which rightly stresses the difference between abstract transaction and human relation, and the importance of integration between individuals and between peoples. Precisely for this reason it 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'. (n. 53). These are not random notes in CV but also appear in other texts of the Church's Social Doctrine and highlight two *caveats* that I consider important. They mark a distance with respect to positions that sometimes can also be found today among the personalists and which excessively expand the scope and

<sup>7</sup> *Gaudium et Spes*, n. 26. See *Mater et Magistra*, n. 69. On the common good see V. Posenti, *Le società liberali al bivio*, Marietti, Genova 1991, Id, *L'uomo postmoderno*, cit., S. Zamagni, *L'economia del bene comune*, Città Nuova, Roma 2007.

scale of relation. Firstly in ontological personalism the idea of relation cannot be led to the limit of declaring the human person nothing more than a 'subsistent relation' if not at the exorbitant price of dissolving the concept and reality itself of the human person (in this case the laudable goal of combating individualism leads to a relationism that dissolves the substantiality of the subject). Secondly, the common good cannot simply be traced back to a relational good: it certainly comes from the cooperative and relational action of the members of society, but it is realized in substantive goods regarding the individuals and society in its hubs and groups.

However it still remains true that the common good emanates from a society that is not a collection of unrelated functional subsystems, each with its internal rules, but is a concrete and actual whole. A sectional and functionalist philosophy of society, rather than a holistic one, is well on its way to not understand the social dynamics and the very idea of common good, which is not the sum of goods produced by different functional subsystems.

7. *Subsidiarity and polyarchy.* Paragraph 67 of CV must be completed by § 57, which rightly emphasizes the principle of subsidiarity, 'particularly well-suited to managing globalization and directing it towards authentic human development. In order not to produce a dangerous universal power of a tyrannical nature, *the governance of globalization must be marked by subsidiarity*, articulated into several layers and involving different levels that can work together'. The same supreme political authority should be organized in a subsidiary and polyarchich way (ibid. and §. 41). The concept of polyarchy thus enters the Church's Social Doctrine for the first time. Polyarchy means that social reality and authority cannot be traced to a single level that incorporates all the rest. Polyarchy, which opposes both monarchy and anarchy, cannot be but an ordered polyarchy, structured according to different levels and in accordance with subsidiarity, unified by global goals, capable of boosting the role of equilibrium and mutual control between the various levels, never forgetting the ultimate goal that is unified and global. Ordered polyarchy is the real subsidiarity, and the true antidote to the dangerous myth of world state and 'world government' (the Pope does not use the latter term which is somewhat ambiguous, and could suggest a world state without multilevel polyarchy and without subsidiarity). The element of polyarchy introduces the constitutional limitation of powers that exists in the tradition of constitutionalism and of the Church's Social Doctrine.

8. CV rightly requires both a reform of international economic and financial architecture, and a reform of the UN, in various ways already advocated by Paul VI and John Paul II, in order to 'give real substance to

the notion of family of nations', to implement the principle of responsibility to protect and also give the poorer nations an effective voice in common decisions (n. 67). The impartial observer of the current situation does not record significant changes in this regard. I personally do not see reasons to change what I wrote in 2005, when I reported the existence of four nuclei that deserved and still deserve our attention:

I) The serious crisis of the multilateral order based on the United Nations involves the stalling of the movement towards worldwide political institutions. In the last few years instability and complexity have increased, especially at the international level, and the temptation to unilateralism and disrespect for international law have also increased. Events in Iraq and the preemptive war of 2003 brought the UN to a serious crisis with the real risk of its substantial irrelevance, a crisis which is not yet fully overcome;

II) The failure to achieve UN development goals and the tangible risk that the Millennium Goals projected to 2015 will be circumvented;

III) The growing problems in the regulation of global trade and consequent aggravation of global inequalities;

IV) Inertia towards the environment and the dangers of global warming.<sup>8</sup>

Despite the extreme need for reforming and strengthening the UN, a reformed UN can be only a distant precursor of a global political authority. To achieve such an authority a strong cosmopolitanism must be present,

<sup>8</sup> In the same essay I added: 'In cases ii) and iii) an economic globalization left to neoliberal orthodoxy, subordinates public decisions to the imperatives of global capitalist integration which weakens the most vulnerable individuals, and leaves unsheltered the effective protection of substantive rights, such as the right to life, freedom from hunger and thirst, basic sanitation and education. Returning to the decision taken by the General Assembly on 8 September 2000 UN Millennium Declaration, many observers are urging the reform of ECOSOC, the Economic and Social Council of the United Nations, turning it into a real Security Council with jurisdiction over environmental crises, social, biological, which trouble the world, on the basis of a combined representation between large economic powers, countries demographically significant and members elected by the UN General Assembly, with powers similar to those assigned to the Security Council already existing. It would seek to (re)construct a global view, that has worsened considerably and often decomposed into sectional and national frameworks. Global governance must be addressed not only to the interests of rich countries, but taking account of developing countries (LDCs), without which they will develop serious distrust of the methods of governance understood as constraints imposed by the strong over the weak', 'Universalismo dei diritti e governance politica globale. Il cammino verso una società politica planetaria', in AA.VV., *Governance globale e diritti umani*, edited by M. Nordio and V. Possenti, Diabasis, Reggio Emilia 2007, pp. 27-47.

which is feeble today, and a kind of recognized legitimacy. But equally important is the ability to identify and achieve shared goals. My opinion is that this point is so fundamental that it may also require some sacrifice on the side of the full cosmopolitan and democratic legitimacy. In other words a world political authority could perhaps precede the formation of a global civil society, which is its natural base. While giving all the weight they deserve to the criteria of subsidiarity and polyarchy, you cannot hide the fact that there will have to be a place where final decisions are taken on the overall purposes and global problems.

#### MODERNITY OF THE SOCIAL DOCTRINE OF THE CHURCH

9. I believe that the CSD (the encyclicals *Pacem in Terris*, *Populorum Progressio*, *Centesimus Annus*, *Laborem Exercens*, *Caritas in Veritate*, etc.) represents a wise and invaluable contribution on social issues, justice, politics, and economics: it is naturally allied to the most sensitive public philosophy of the last half century, and sometimes more advanced and progressive. This assessment is especially fitting for the political domain, where this doctrine represents perhaps the most authentic future for politics with acquisitions that are not present in important thinkers of the 20th century. I refer to three of them, and precisely on the problem to progress towards worldwide political institutions.

Hans Kelsen felt the mortal risk represented by sovereignty, but he did not go beyond a draft organization of world society, developed only at the juridical level and drastically undermined by its extreme legal positivism that excludes all natural law. In his research on war and peace Norberto Bobbio recognized prominence and importance of international political institutions, though without reaching the idea of world political authority, which he mistrusted because, following Hobbes, he thought of it as a tyrannical superstate without subsidiarity. Jürgen Habermas has recently taken up the Kantian project of perpetual peace, without in my opinion going beyond the realm of law to enter that of politics.<sup>9</sup> The categories themselves

<sup>9</sup> H. Kelsen, *Il problema della sovranità*, Giuffrè, Milan 1989; H. Kelsen, *Pace attraverso il diritto*, Giappichelli, Turin 1990; E. Kant, *Per la pace perpetua. Progetto filosofico* (1795); N. Bobbio, *Il problema della guerra e le vie della pace*, Il Mulino, Bologna 1984; J. Habermas, *L'inclusione dell'altro*, Feltrinelli, Milan 1998.

of modern politics (indivisible sovereignty, power, conflict) and its paradigm, often focused only on force, are inadequate, while the paradigm of the Church's Social Doctrine rests on the hinges of the common good, authority, justice, subsidiarity, and solidarity. From this side it shows the need to escape from the Hobbesian and Hegelian scheme, unhappy legacy of modernity, for a new beginning.<sup>10</sup>

#### SOLIDARITY AND THE UNIVERSAL DESTINATION OF GOODS

10. The third term of my paper concerns solidarity, which is a central criterion of SDC, similar to that of cooperating care for the common good. The use of the term solidarity has grown over time and has taken a great and justifiable extension: it is contained in the message of Christianity. The initial question is as follows: is there in the ethics of creationist religions a central principle which we can appeal to motivate solidarity (and gift), not only as an individual attitude that more or less depends on the goodwill of the individual, but as a universal standard that governs the acts of justice and generosity? And this especially in economics? I answer affirmatively, identifying it in the *principle of the universal destination of world's goods to the whole human family*: it can effectively stimulate a new and deeper reflection on economics and its purposes.

In the question of solidarity and of a civil economy, CV adequately introduces the significance of the gift and its logic, which does not require return or exchange of equivalents in the market (nn. 36-39). This logic therefore thinks of the economic and political phenomenon according to three terms: market, civil society, state, going beyond the sharp market-state polarity. CV does not seem to explicitly invoke the principle of the universal destination of the world's goods, constantly present in the tradition of the Church's Social Doctrine. It is asserted in the encyclicals to which CV

<sup>10</sup> I have devoted numerous studies to these issues, including: V. Possenti, 'Sovranità, pace, guerra. Considerazioni sul globalismo politico', *Teoria politica*, n. 1, 2006, pp. 57-79; 'Mondialisation, souveraineté, paix perpétuelle. Les perspectives de Kant et de Maritain', *Recherches philosophiques*, tome IV, 2008, pp. 17-38 (in Italian: 'Mondializzazione, sovranità, pace perpetua. Le prospettive di Kant e di Maritain', *Coscienza*, n. 4-5, 2008, pp. 52-63); V. Possenti, *Frontiere della pace*, Massimo, Milano 1973; Id., 'The Governance of Globalisation: Ethical and Philosophical Perspectives', AA.VV., *The Governance of Globalisation*, a cura di E. Malinvaud and L. Sabourin, Vatican City, 2004, pp. 219-228; Id., *L'uomo post-moderno*, cit., ch. III.

makes more continuous reference (*Populorum Progressio* and *Sollicitudo Rei Socialis*), and of course in the Second Vatican Council which in *Gaudium et Spes* writes: 'God intended the earth with everything contained in it for the use of all human beings and peoples. Thus, under the leadership of justice and in the company of charity, created goods should be in abundance for all in like manner' (n. 69). Referring to this text *Populorum Progressio* added with particular force: 'All other rights, whatever they may be, including the rights of property and free trade, are to be subordinated to this principle. They should in no way hinder it; in fact, they should actively facilitate its implementation. Redirecting these rights back to their original purpose must be regarded as an important and urgent social duty' (n. 22). The *Sollicitudo Rei Socialis* points out with equal force that the universal destination of goods is 'the characteristic principle of Christian social doctrine' (n. 42). It occupies a higher rank than the legitimacy of private property, which is a current mode, but not the only one, to secure it. Indeed, this principle refers to the *use* and not only or mainly to *property*; it requires that the turnout of the assets sufficient to live be guaranteed to all.<sup>11</sup>

11. *Some reflections on the universal destination of goods.* With the cardinal principle of the universal destination of goods the relationship between capital and labor does not arise at the center of the investigation, but you get into a more original determination concerning the relationship between *person* and *property*. Now, if it is true that labor is the primary source of wealth of nations, the principle of destination of the earth to all men suggests that there is a right to such property (to be defined properly) even before its appropriation through labor. The idea that there are some things that belong to man as man, possibly in ways not subject to the logic of commutative exchange of goods, expresses in a strong way the personalism of CSD. It thus becomes possible to judge any allotment of property: as all distributions historically given deviate more or less strongly from that criterion, it is unavoidable to conclude that there is no ownership of assets that can be considered definitely just. The right to private property, maintained in its truth by the

<sup>11</sup> It is comforting that an economist of high value as M. Monti has captured in CV the importance of world political authority for the proper economic dynamics (see interview with *Avvenire*, 'Per l'economia un'Autorità globale. La sfida dell'enciclica', a cura di F. Ognibene, 2 agosto 2009, p. 6). In the same interview Monti also noted that the criteria of justice and distribution of economic goods between individuals and peoples are not sufficiently developed in the encyclical. Perhaps this outcome could have an origin in the lack of attention to the universal destination of goods.

principle of the universal destination of goods, constitutes a universal right to property, not an unlimited right, so the accumulation of property and wealth cannot be considered legitimate a priori, but will require justification according to its actual benefit to the community. The principle of the universal destination of goods is rooted in biblical wording, especially in the book of *Genesis*, where the explicit intention of God the Creator is to allocate land use and what it contains to humankind, not to this or that privileged group. It would not be impossible to document the persistence of that principle in the history of the Church from apostolic times, although it has undergone ups and downs over the centuries and produced consequences only to a limited extent, also for the non-existence or the reduced measure of globalization, which conversely today is remarkable.

Broadly interpreted and read with the categories of justice, this principle extends to different goods: material ones such as land and raw materials, and 'intangible' ones such as labor, skills and craftsmanships, as means to achieve income and property, and finally 'access goods' as participation in world trade. This principle therefore concerns not only the natural assets such as land, air, water, sun, differently distributed by what might be called the natural lottery and historical events. It also involves the goods manufactured by man, whose distribution is now highly unequal: and whence the greater tensions, because the goods immediately usable for human consumption without working-processing activities are limited in number and quantity. Access to goods manufactured normally takes place through national and international trade, but this is now dominated by countries with strong consequent marginalization of small producers, precarious terms of trade for the weaker party, concentration of capital in few hands. In all areas mentioned there is no hope of reaching a less satisfactory allocation without the contribution of converging social security, legal, commercial, health, national and international institutions.

Another urgency regards goods of knowledge, culture, and art: how to involve all people, since the criterion of universal application also extends to them? On the one hand, their spread is easier, because the nature of such goods is to be shared indefinitely without diminishing or decay. On the other hand this which should make the task easier, because it is easier to enjoy all of what is universal and not suffering from consumption, reveals an additional barrier. This comes not from the scarcity of the goods of culture – they may even be made accessible through the media system to every man – but from the condition of the subject. For these goods the most difficult task is to educate people to enjoy them, and this often requires a very high commitment to training.

An equally significant problem concerns technology, whose uneven distribution worsens that of primary goods. We should consider technical knowledge as a common good and a heritage of humanity, to which all should have access. *Centesimus Annus* grasped something similar, by observing that in the world today immaterial forms of poverty develop, involving the deprivation of knowledge, technology, know-how and show-how.

Betting on the initiative of individuals, encouraging forms of free work, enterprise and participation tends to create a less imperfect criterion of universal destination of goods, and to ensure a more efficient use of resources. If you need to create goods, the start of a process of development and improvement of systems of political economy are prerequisites for implementing the principle in question. Its implementation has also been hindered by inefficiency and waste of any kind that have marked and still mark the forms of economic organization realized in history. The roughness and primordial stage of many systems of political economy make it so easy to waste the gifts of God to mankind, and so difficult to developed them for the benefit of all. The field of aid to development would require following the method of 'teaching to do'. I remember a Chinese proverb: if someone is hungry, do not give him a fish, but teach him to fish.

## CONCLUSIONS

I have presented some elements of a structural analysis that focuses on the difference between the existence of a global human community and the lack of a multilevel global governance. Such governance cannot be reduced to a spontaneous mechanism: I do not support the saying which rather usually says 'governance without government', or also 'governance without authority and decisions'. Lack of governance is found today mainly in economic and technological globalization, due to the frailty and poverty of political responsibility. Besides, the existence of a multiple crisis as indicated at the beginning, cannot be resolved at a single level, but requires multiple and coordinated responses. The axiom that there cannot be governance without authority recalls the importance of the generation and organization of authority and decision. What can be expected is that the major global leaders bear it in mind in making their decisions.

In concluding I propose some considerations on a few aspects of the international situation concerning the financial, juridical and political levels.

– We stand in need of a global governance in financial operations, because the financial market cannot be regulated by national authorities alone. And this requires an extension and a strengthening of international institutions in order to reach stability and protect against irresponsible behaviors in the world market.

– The perspective of a world common good would require adhering faithfully to the major international institutions. Important is the example of the International Criminal Court (ICC), which some large countries (China, India, Russia, USA) have so far refused to join.<sup>12</sup> The resulting message is negative and based on a concept of state sovereignty, the great myth of modern politics that drips blood and tears, which is realized in the ruinous criterion of *superiorem non recognoscere*. And it is this myth that makes so impervious the road designed by PT and CV: they ask that the world Authority be governed by the law and enjoy an effective power to ensure security, justice and respect for human rights.

– Another perspective that seems to me unfounded is the idea, put forward in recent years, of a league of democracies to replace the UN, deemed to be too restricted by many obstacles. That league would conduct more freely war, defense, and if necessary the duty to protect. Despite its possible greater efficacy in respect of the UN, such a league does not seem desirable since it lacks real international legitimacy, which on the contrary the Security Council and the initiatives it approves have. It could embark on initiatives not sufficiently motivated, and perhaps contrary to international law and the traditional doctrine of just war, with the risk of assessing only its own interests and not the global ones. Furthermore, democratic states would be elevated to a privileged status. On the other hand it would be mere idealism not to assess the deep difference between democratic and quasi-democratic States, and States based on totalitarianism and dictatorship. It is true that States of the second type are a permanent risk for the achievement of common good and peace, but this should not lead to the abolition of UN.

<sup>12</sup> For the U.S. see the campaign against American accession to the ICC conducted by *The New American Century*: ‘whatever the respectable Motives behind the creation of the International Criminal Court, We Should not Let Those blind us to the fact That the preservation of a decent world order depends chiefly on the exercise of American leadership. For Both geo-political and Constitutional Reasons, We Should not be in the business of delegating That leadership now compounding the Difficulties of ITS exercise by creating unaccountable, supra-national bodies’ (Gary Schmitt, *The New American Century*, 02/01/2001).

– An additional knotty problem concerns the rejection of the doctrine of preemptive war, through which some states regain possession of the sad and fatal right to declare war. This doctrine re-introduces in a broad and uncontrollable form the *jus ad bellum* of states (especially the more powerful ones), proposes again the legitimacy of war as a means of resolving international disputes, restores an unquestionable and unpredictable war-power, weakening the brakes of prudence and fostering a vehement and thoughtless treatment of policy issues. In the doctrine of preemptive war, the State which intends to declare it is both judge and party, claiming the right to determine when, how and why to have recourse to weapons. It is unwise to forget what the Dominican Father Cordovani Mariano (1883-1950), Master of the Sacred Palace, wrote back in 1939 not on preemptive war but on just war: ‘The terms of the theology of just war occur very rarely and, if we were to do a theological analysis of war literature, even among Catholics, so many guilty errors would come out’.<sup>13</sup>

<sup>13</sup> 1939, *Corso universitario di teologia cattolica*, Volume III (Studium 1946).

HOW DO WE 'RE-PLAN THE JOURNEY'?  
COMMENTS ON THE PAPERS BY PROFESSOR LLACH<sup>1</sup>  
AND PROFESSOR POSSENTI<sup>2</sup>

HSIN-CHI KUAN

OVERVIEW

Both papers have presented very far-sighted views of 'the Crisis' and offered an in-depth exploration of our way forward. Professor Llach envisages the dawn of 'a historical, civilization-wide change' of our world, or of the 'East coming back'. More specifically, it is going to be a shift of 'the axis of the world's economic power from the Atlantic to the Pacific'. The forecast is based on broad trends of sustainable economic growth of the emerging countries. To chart our way ahead, Professor Llach argues, we need to solve first, the commitment problem, or problem of enforcing international regulations and policies and then the 'conflict between world capitalism development and postmodern values and culture'.

Professor Possenti's paper draws a broad picture of the multi-faceted nature of 'the Crisis', a matter going beyond the world economy. It is a meta-crisis involving four different but interrelated problems of globalization, capitalism, culture and justice. To address the problem of how to govern globalization, he argues for the formation of a global political authority, with extensive reference to the Church's social doctrine.

<sup>1</sup> 'The Crisis, its Aftermath and the New Role of Developing Countries'.

<sup>2</sup> 'The Governance of Globalization: Global Political Authority, Solidarity and Subsidiarity'.

### WHAT IS 'THE CRISIS'?

This is indeed the basic question. Both Professor Llach and Professor Possenti acknowledge the existence of a crisis. For the former, the focus is on its scale, as revealed by his question 'Is there a *global* financial crisis?' Possenti is, instead, more interested in the *nature* of 'the Crisis'.

In Table 1, Professor Llach impresses us with the pattern of inequality in economic growth/decline during the global financial/economic crisis. It suggests that the so-called global crisis is not global. Rather, its impact is very uneven across regions and countries. The suggestion can be buttressed further by presenting China's experiences with this global financial/economic crisis. For her, the crisis' effect is mild and short-term, as compared to many other countries. In fact, it has turned out to be a great opportunity. The adversity involves just a slowdown in growth rates in the economy, trade (especially export), foreign investment, consumption, and industrial production. The year 2009 is the worst, especially for export which suffers a 16% decrease compared to 2008, against an average 20% annual growth rate during the decade up to 2007. On the positive side, however, the crisis has awakened the Chinese leadership to the risk of the export- and foreign investment-led growth strategy of the past. As a result, an alternative, domestic demand-driven growth strategy already advocated by some economists in the past has now gained the upper hand. The crisis has also accelerated the restructuring, merging and upgrading of industrial enterprises with a view to improving competitiveness and the adoption of corrective measures to uplift the livelihood for the peasants who had suffered from exploitation by the regime in past decades. The latter approach will bear great significance to the prospect of the demand-driven strategy of growth. In addition, outstanding reforms of the energy price formation mechanism, public finance system, investment regime and state enterprises all received renewed attention. Last but not least, there is a marked increase in self-confidence as China's reputation in the world grows enormously despite the odds of the crisis.

As mentioned above, the subject matter for Professor Possenti is the nature of 'the Crisis'. It concerns globalization as a whole. The crisis of the global finance and economy should not be regarded as an isolated phenomenon in human interactions at the global level. This is a sound approach but begs the question about the nature of globalization as a crisis. The answer is a structural mismatch between the existence of a global community of human destiny and the lack of global governance. In a speech given

in Barcelona in 2004, fellow academician Professor Joseph Stiglitz has advanced a similar idea to the effect that the problem of globalization lies in the fact of economic globalization having outpaced political globalization, in the context of a greater need for collective action driven by closer integration of the countries of the world. Professor Stiglitz' concern is confined to the economic aspect only. Professor Possenti's 'human interactions', on the other hand, can encompass many more, such as global problems of social disparities, population growth, migration, environmental degradation and cultural relativism. There is thus no wonder why he urges for a general solution by means of a global political authority, whereas Professor Llach as an economist prefers a narrower understanding that ends up addressing two more concrete, but no less important issues in the search for a new journey plan, i.e. (1) commitment problem, or problem of enforcing international regulations and policies and (2) conflict between world capitalism development and postmodern values and culture. I shall presently address these strategic considerations for re-planning our journey. Let us first examine the trends of global issues, since any solution depends on the course of the trends.

#### OUR WORLD IN 2040?

Trend analysis is not done in Professor Possenti's paper but constitutes the major contribution by Professor Llach. The world will be very different in the year 2040, we are told. It will be an era of the Pacific. We will observe the dominance of emerging countries and the decline of the developed ones in the West. The historical, civilization-wide change is marked by a new role of emerging countries under Asian leadership. The above forecast is based on evidence of broad trends. But if we look at Table 4 more closely, what is most striking is actually not the story about Asia, but China. If we really let the facts speak for themselves, there would have to be a new role of emerging countries under China's dominance. Is China's growth trend really sustainable to ensure her dominance in the world?

Taking the share of the world's GDP as proof of dominance, it is apparent that with 40% share, China will become in 2040 the single most prominent power in the whole world (See Table 4 in Professor Llach's paper). The world will be, in the language of international politics, a 'unipolar system', with China as the sole superpower. With a superpower in place, it is superfluous to speak of a regional leadership. The regional framework can only

be a façade at best. China as the sole superpower carries significant implications for the problem of global governance. There are two scenarios. First, if China would become capable of leaving all other countries far behind in terms of national power, the world system will tend to be unstable, as the power cycle theory will predict.<sup>3</sup> The power cycle theory may be wrong; China could perhaps evolve into a benevolent hegemon who wields decisive influence in the governance of the world, thereby ensuring global stability.<sup>4</sup> Whatever the scenario, it hinges on the question of whether China will in fact become 'the Number One'. Recall that in the 1970s Japan was hailed as a rising economic power,<sup>5</sup> a proposition only to be falsified after the 1990s. In the same vein, it may also be premature to predict that China will become the number one. As pointed out by Professor Steve Chan,<sup>6</sup> the possibility that China may one day overtake the U.S. will depend on the ability of the former to develop its human capital and undertake technological innovations, in which the U.S. still enjoys an advantage.<sup>7</sup>

#### WHAT ARE THE PROBLEMS?

The problem of governing globalization goes beyond reigning in economic and political power for the sake of global stability, especially not just in terms of prevention of war. This is the message I get from Professor Posenti. He explicitly states that '(T)he global political authority is necessary in principle for managing globalization, not only to remove the war. Its

<sup>3</sup> Charles F. Doran and Wes Parsons, 'Wear and the Cycle of Relative Power', *The American Political Science Review*, Vol. 71, No. 4 (Dec. 1980), pp. 947-965.

<sup>4</sup> For the two schools of thought about hegemonic stability, consult Robert O. Keohane, 'The theory of Hegemonic Stability and Changes in International Economic Regimes, 1967-1977' in Ole R. Holsti, R. Siverson, & A. George, eds., *Changes in the International System*, Boulder: Westview, 1980; George Modelski, *Long Cycles in World Politics*, Seattle: University of Washington Press, 1987.

<sup>5</sup> See Ezra Vogel, *Japan as Number One: Lessons for America*, Cambridge: Harvard University Press, 1979. Two more books by Professor Vogel were published as sequel to the 1979 one: *Japan as Number One Revisited*, Singapore: Institute of Southeast Asian Studies, 1986 and *Is Japan still Number One?* Selangor Darul Ehsan, Malaysia: Pelanduk Publications, 2000.

<sup>6</sup> 'Is There a Power Transition between the U.S. and China? The Different Faces of National Power', *Asian Survey*, Vol. 45, No. 5 (Sep.-Oct. 2005), pp. 687-701.

<sup>7</sup> Apart these two assets, I would add America's advantage in having a liberal immigration policy that can attract talents all over the world.

necessity is clear from the very theme of the common good, which has become global dimension'. He makes reference to the encyclical *Mater et Magistra* of John XXIII that the common good is in the 'sum total of social conditions which permit and foster in human beings the integral development of their person'.

The common good brings me back to Professor Llach's second issue for 'world governance', i.e. the conflict between world capitalism development and postmodern values and culture. It is a matter of values or culture that underlies any plan for human development. They shape public policies at various levels of government. At this general level of understanding of the conflict, Professor Llach has brought up an important perspective in our search for solutions. At the substantial level however the conflict is mis-specified here as one between world capitalism development and postmodern values and culture. The values and behaviors desired by Professor Llach are 'justice, intergenerational solidarity and an active subsidiarity'. They are in conflict with the unbridled capitalism of today, expressed as de- or unregulated market forces and poor ethical foundation of economic decisions and activities which are driven by the pure profit motive. Those values mentioned by Professor Llach are just in short supply in postmodern societies. They are not values of postmodern societies. To integrate the substance of Professor Possenti into the analytical framework of Professor Llach, we get a more generalized value conflict of a global scale between parochial goods and the common good. Without the latter prevailing in collective decisions in human interactions, our world will remain fragmented, conflict-ridden and ungovernable. Without the common good accepted widely, it is difficult to have a fair global political authority.

However, Professor Possenti seems not to be too pessimistic about the goal of global political authority. The prospect is not close, we are assured, and 'what can be expected is that the major global leaders – political and economic – to take this in their decisions, and that alone would be an outcome of greatest importance'. I must say that he has failed to take seriously the commitment problem as alluded to by Professor Llach.<sup>8</sup> The commitment problem is real and prevalent for all regulatory frameworks agreed upon among sovereigns. The reason is obvious: given the basically anarchical nature of world politics, there is no superior authority above sovereign

<sup>8</sup> Professor Possenti does acknowledge the problem when he notes the fact that China, India, Russia and USA have so far refused to join the International Criminal Court.

states to enforce rules and policies. It is ultimately a system of self-help. In general, enforcement of agreed mutual commitments or rules in international relations depends on voluntary compliance, tit-for-tat in case of violations, or norm of reciprocity.<sup>9</sup> All these are imperfect ways in which commitments to values and code of behavior can be assured. They are no substitute for a global regulatory framework with provisions for legal liability, monitor mechanism and sanction for violations. When power is the dominant currency in international relations, the commitment problem is most severe when a big power refuses to commit itself no matter what and even when there is already a commitment, there is no authority to sanction it for non-compliance.

We are in a vicious circle. We need institutions to solve global problems. Yet, the principle of supra-national authority is locked in a conflict with national sovereignty. And national sovereignty cannot be overcome so long the world is anarchic without any central authority to provide for peace and justice. There seems no quick fix of the vicious circle. A return to incremental, pragmatic paths seems in order.

#### APPROACHES TO INSTITUTIONALIZING SOLUTIONS FOR GLOBAL PROBLEMS

Professor Possenti has a grand vision for global political authority to manage globalization. It is a multi-functional and 'multi-layered from the bottom up' system of global institutions for governing globalization. The vision is very general and requires further specifications. An alternative, more practical approach would be to examine existing forms of governance in terms of their nature, operations and degree of effectiveness. He does mention some institutions, albeit only in passing, such as the International Criminal Court to which major world leaders 'should adhere faithfully to' and the United Nations as 'only a distant precursor of a "global political authority"'. Yet, the whole paper is very theoretical. A more empirical approach may yield the results that all current attempts to reign in globalization are ineffective, or that they vary greatly, depending on the nature of

<sup>9</sup> 'Reciprocity' is a concept coined by Robert Jervis in his explanation for the success of the Council of Europe between 1918 and 1923. It refers to a standard of behaviour based on each statesman's belief that if one moderated his demands or forbore to take advantage of others' temporary weakness, they would reciprocate when the tables were turned. See 'Security Regimes', *International Organization*, Vol. 36, No. 2 (Spring 1982), pp. 357-378.

specific global problems and other factors. Such an exercise may strengthen the paper's argument for the need for a single political authority of the world, especially when it is found that a fragmented system of international institutions/regimes has failed to provide a coherent and effective solution to the global problems.

Modern history of international relations knows these following approaches to global governance: world government, international government, international governmental organization, (global) civil society, international regimes, and the model of European Union. The multi-functional, 'multi-layered from the bottom up' system of global political authority as proposed by Professor Possenti could be a combination of some of these approaches.

The core of the global governance argument concerns the acquisition of authoritative decision-making in the context of pluralist views and interests. A world government is a domestic government *writ large*, vested with recognized and final power to authoritative decision-making. It is a tall order to reconcile such a conception of world government with the Church's principle of subsidiarity.

Short of a world government, global problems can conceivably be resolved by a hegemon who can develop and enforce the rules to govern the world. As a result, world crisis can be averted and stability in international relations maintained. Such an idea was advanced by Charles P. Kindleberger who blamed the Great Depression (1929-1939) on the lack of a world leader with a dominant economy.<sup>10</sup> The idea can hardly be accepted today since the financial crisis originated in the United States which is still the single superpower left after the end of the Cold War. China seems a poor candidate even if she may become dominant in 2040 with a 41% share of the world's GDP.<sup>11</sup> The theory of hegemonic stability is surely not the same as the call of the Church for a world political authority, given the paramount principle of subsidiarity and of the common good.<sup>12</sup>

<sup>10</sup> *The World in Depression: 1929-1939*, Berkeley: University of California, 1975.

<sup>11</sup> Data from Robert Foget, as quoted in Professor Llach's paper.

<sup>12</sup> The experience of China's economic growth offers a good example of the value conflict. Apart from the five factors offered by Professor Llach for the increasing prominence of the emerging countries in the years to come, the factor of 'state capacity' is crucial for China. This factor cannot be subsumed under 'better economic policies'. Let me just illustrate with a prominent case. Before the crisis, on 26 June, 2007 the National People's Congress of China had enacted a new law of employment contracts to better protect the rights

A ready alternative to the world hegemon is the United Nations. Its performance has always been controversial. Realists in political science call it an international government by super – or big – powers. The same critique may be applied to other international governmental organizations. For instance, who governs the IMF? Professor Possenti does not place his hope in the United Nations which is only a distant precursor of a *global political authority*. Instead, he privileges the (global) civil society,<sup>13</sup> saying that it is the natural base of the political world. To its critics, (global) civil society as of today is primarily a Western phenomenon, there is a long way to go before it can be regarded as a precursor of a global political authority. Protagonists however stress that civil society is already an element in the present architecture of global governance. There are many international non-governmental organizations nowadays. They are active actors in a highly disaggregate system of agency which has the capacity to get things done at the international level, without the legal competence to command that they be done. Even this is the case, it is hard to see how the global civil society can be transformed into a global political authority, since the former is a centrifugal phenomenon driven by specific policy issues and reinforced by the desire to maintain autonomy in actions. Instead of conceiving civil society as a promoter of a political authority, it is better to expect it to keep a distance from and serve as a check against the global political authority once established.<sup>14</sup>

Can international regimes facilitate the formation of a global political authority? International regimes are outcomes of voluntary agreements

of workers. When the adverse impact of the global crisis was increasingly felt in China in the second half of 2008, some of the provisions, including the minimum wage mandate, were suspended for implementation. No labour protests ensued. This is in stark contrast to the Greek government whose package of fiscal constraints met with strong opposition. This means that China has succeeded partly because of low human rights costs between which and economic prosperity there is a severe value conflict. The risk for global governance is whether the bad currency will drive the good one out.

<sup>13</sup> Apart from the (global) civil society which is the most important, Professor Possenti cites three other preconditions for the emergence of the global political authority: a strong cosmopolitan feeling, a kind of recognized legitimacy and the ability to identify and achieve shared goals. All these are important points for the way forward and need further elaboration.

<sup>14</sup> For a debate on the contested future of global civil society, please consult Gideon Baker & David Chandler, eds., *Global Civic Society: Contested Futures*, N.Y.: Routledge, 2005; Krishan Kumar, 'Global Civil Society', *Arch. Europ. Sociol.*, XLVIII, Vol. 3 (2007), pp. 413-434.

among nation-states. As frameworks of implicit or explicit principles, norms, rules and decision-making procedures, international regimes function as devices to overcome the barriers to more efficient coordination identified by theories of market failure.<sup>15</sup> There are great variations among international regimes. Taken as a whole, they constitute a disaggregate system, much like the global civil society. On the other hand, unlike the civil society, international regimes are better connected in certain areas. Robert O. Keohane has given an example of the trade regime as follows:

An agreement among the United States, Japan, and the European Community in the Multilateral Trade Negotiations to reduce a particular tariff is affected by the rules, norms, principles, and procedures of the General Agreement on Tariffs and Trade (GATT) – that is, by the trade regime. The trade regime, in turn, is nested within a set of other arrangements – including those for monetary relations, energy, foreign investment, aid to developing countries, and other issues – that together constitute a complex and interlinked pattern of relations among the advanced market-economy countries. These, in turn, are related to military-security relations among the major states.<sup>16</sup>

The ‘nesting’ of international regimes can be regarded as a process of functional integration with spill-over effect from one area to another, thus leading ultimately to the formation of a more encompassing security community as the natural base of a political authority. There is no automatic transformation from a sufficiently nested community of international regimes into a global political authority. A global political authority requires a consciously constitutional engineering, with international regimes as probable, major elements. Constitutional engineering is a moment of inter-governmentalism, with diplomacy<sup>17</sup> playing a decisive role. Unless a consensus can be reached at points of hard negotiation, no new path can be successfully shaped.<sup>18</sup>

The prospect for a global political authority is very dim at present. The closest model of hope is offered by the experience of European integration. The question is whether a regional experience can be generalized to the

<sup>15</sup> See Robert O. Keohane, ‘The Demand for International Regime’, *International Organization*, Vol. 36, No. 2 (Spring 1982), pp. 325-355.

<sup>16</sup> *Ibid.*, p. 334.

<sup>17</sup> In the age of globalization, the world summit has become a dominant form of diplomacy for coordination of national policies on global problems.

<sup>18</sup> The constitutional engineering of the EU was stalled in 2005 and 2008.

global level. The incomplete success of European integration is the outcome of a confluence of very unique factors.<sup>19</sup> First is the window of opportunity, i.e. a context of deep reflection after two devastating world wars, the need for coordination in post-war reconstruction and the Soviet threat. The second but no less significant requirement<sup>20</sup> was the availability of political entrepreneurs who had cooperated with each other during the pan-European anti-Nazis movement and had the vision to transcend narrow-minded nationalism. Thirdly, European integration was initiated also as a peace project. It was initially conceived as a small project confined to six nations but evolved into an open-ended, incremental, and long-term task to institutionalize specific structures and processes of regional governance. The first step of institutional construction is crucial. As supra-national jurisdictions laid down for the European Coal and Steel Community, i.e. the High Commission and the European Court of Justice, have evolved into bulwarks and engines for continued integration. The functional logic of cooperation (integration in one area entails the need for integration in another one) together with the dynamic of supranational institutions work to keep member states on the haphazard path of expansion and deepening. As a result, the EU of today can be proud of being a successful, innovative scheme of supranationalism, unsurpassed by any alliance, free-trade zone, international governmental organization or regime.<sup>21</sup> Having said that however, the EU is not yet a regional political authority, in the true sense of the world. For instance, it still suffers from the commitment problem as witnessed in the Union requirement of fiscal restraints. It is risky to generalize the European experience to the global level. The experience, to conclude, represents only a useful lesson for the construction of a global political authority. Initial conditions matter. But is there a window of opportunity now? Where are the required political entrepreneurs? Is there a role for the Church?

<sup>19</sup> Culture is neglected here, because I am not entirely sure about the exact role of the common European culture in the installation of the integration process, given the prevalence of wars in the past. Otherwise, it makes sense to hypothesize cultural homogeneity as a facilitator for international political cooperation.

<sup>20</sup> Under the assumption of self-interest, the existence of common goals alone does not entail voluntary collective action among members of a community to achieve them. Leadership is crucial to overcome the logic of collective action, especially in the context of a large, heterogeneous community.

<sup>21</sup> It is difficult to characterize the EU for the lack of any precedent. Nevertheless, Kersbergen and Verbeek apply the analytical tools of international regime theory to study the history and role of subsidiarity as a norm in 'the competence regime' of the EU

between 1991 and 2005. See Kees Van Kersbergen and Bertjan Verbeek, 'The Politics of International Norms: Subsidiarity and the Imperfect Competence Regime of the European Union', *European Journal of International Relations*, Vol. 13, No. 2 (2007), pp. 217-238. It remains unclear though whether they regard the EU as an international regime or they just talk of its competency regime. It is possible to see the EU as 'a web of international regimes' across many functional areas, on the grounds that it is after all a system of international treaties. No other international regime has ever reached the level of multi-functionality and structural differentiation (into legislative, executive and judicial branches) like the EU.

## COMMENT ON HOW DO WE 'REPLAN THE JOURNEY'

JUAN JOSÉ LLACH  
THE CRISIS, THE AFTERMATH AND  
THE NEW DEVELOPING COUNTRIES

VITTORIO POSSENTI  
THE GOVERNANCE OF GLOBALISATION:  
GLOBAL POLITICAL AUTHORITY, SOLIDARITY  
AND SUBSIDIARITY

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My task is to comment on the papers of Prof. Llach and Prof. Possenti. The task is not without some complications. The first part of this morning dealt with the same general subject. But the rapporteurs were asked very basic, central and general questions. The rapporteurs of the second part of this morning, however, were to draw and explain more special pictures. And they did it in correspondingly different ways. Professor Llach concentrated his presentation on facts and numbers: facts and numbers showing differences in wealth and shortage. Professor Possenti concentrated his presentation on ideas: ideas formulated within papal documents, and philosophical works. Let me try to formulate some observations in both directions.

Professor Llach's report is above all a pre-eminent challenge. Its main merit is to surprise. To surprise fundamentally. It questions our 'normal' picture of the distribution of wealth and poverty, of economic resources and lack of them, of economic power and economic weakness. Mainly looking back on the past: the past years, the past decades. Sometimes looking into the future. The furthest view going as far as 2040. What can we learn from these exercises? We know the question is: 'How to replan the journey?' What lessons can we draw to answer the question rightly? I think questions

are the main harvest of reading Professor Llach's report. What are the adequate criteria to differentiate and to quantify realities? To make differences and to neglect differences? This analysis, however, has two sides to start from and to aim at. One is social reality – especially the economic, demographic, and potentially also the cultural reality or other features of reality. But what time of finding should be the decisive one? The present time alone? The experience of what past? The expectation of what future? The other side from where to approach the analysis of relevant structures is global governance itself. How do the elements of social reality interact with the institutional elements of global governance? With the elements of the given system? With the elements of a potentially reformed system? One sees what wide net of unknowns opens up behind the selective assumptions of the report. But how to approximate an effective solution?

At this point let us turn to the other report, which is to be commented here: Professor Possenti's presentation. It starts out with the side of the organisation of global governance, and this with a very helpful definition: 'By governance I mean the whole of the functions of government and control, authority and direction, decisions and purposes that it is necessary to exercise in the political, economic, legal, social and communicative fields, for the achievement of a positive outcome and of an equitable allocation of public goods'. Starting from this point the report shows that this system must not be concentrated on economics – neither on the social forces running the economy nor on political bodies responsible for economic matters. On a varied way of ideas he argues that global governance refers to a very wide field of human conceptions, principles and attitudes like morals and behaviour. This way culminates in the observation that the most urgently missed development is a global authority, which when adequately structured implements subsidiarity and solidarity. And adequately structured means 'polyarchic'. Thus the river of our thinking comes to the mystery of a solution, which is already shown by *Caritas in Veritate*. It is a productive puzzle. It shows us a responsibility, a task. In this point *Caritas in Veritate* and the report match.

To summarize: What do we, having behind us this stage of work, know more and better? I think we know more about our uncertainty. That is good for preventing us from acting under the false precondition of certainty. But is it enough to reduce the risks of wrong action or even non-action as far as possible? Is it enough to show at least the directions and the methods to come nearer to feasible projects of action?

I put these questions as this meeting demonstrates very intensively the intention which lead to the foundation of this Academy. The *raison d'être* of our Academy is formulated in our statute: to offer the Holy See elements for the development of the Social Doctrine of the Church. When I was confronted with the invitation to offer a comment and when I studied the program and the papers I became disturbingly aware how the conditions for our being and our responsibility over the sixteen years since our foundation have developed. I asked myself: What part of our work could the Pope have made use of? What did He make use of? What part of the Pontifical Teaching with which we agree is our merit? What part of the Pontifical Teaching with which we disagree could have been prevented if we had worked more convincingly?

## PANEL ON FINANCIAL MATTERS

# THE ROLE OF MACRO-PRUDENTIAL OVERSIGHT AND MONETARY POLICY IN PREVENTING FINANCIAL INSTABILITY

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## I. INTRODUCTION

Over the past three years, we have experienced a financial and economic crisis of exceptional scope, severity and complexity. Since the summer of 2009, financial market conditions have broadly improved and the European and other economies have been gradually recovering. Nevertheless, the crisis is not over yet. Financial market tensions persist and significant policy challenges remain, as developments in the sovereign debt markets in recent weeks have amply demonstrated. The ongoing adjustment in the banking system and the sizeable fiscal imbalances – largely but not entirely due to the crisis – still cast a shadow over the outlook for global economic developments and financial stability.

The experience with the crisis has triggered a comprehensive and far-reaching set of policy responses aimed at preventing the occurrence of similar episodes in the future, as well as better managing crisis situations and mitigating their effects. At the core of these actions and initiatives is the regulatory and supervisory reform agenda that is being pursued by the Financial Stability Board under the political guidance of the G20 leaders. This agenda aims primarily – though not exclusively – to reinforce the resilience of the financial system by various means, mainly by strengthening the regulatory and supervisory framework of financial institutions and markets.

At the same time, the crisis has clearly demonstrated the need to adopt a macro-prudential approach to the regulation and supervision of the financial system as a whole. As a result, in Europe and elsewhere new institutional frameworks for the macro-prudential oversight of the financial sys-

tem are being established, and it is expected that central banks will play a key role in performing the relevant tasks.

In my remarks, I will address a number of relevant and interrelated questions:

- What is the role of macro-prudential oversight in safeguarding the stability of the financial system as a whole? In particular, what are the specific tasks to be performed and the instruments to be employed in achieving its objectives?
- What is the envisaged role of central banks, and in particular of the ECB, in the conduct of macro-prudential oversight in the European Union?
- What contribution can monetary policy make to preventing financial instability? And how does it relate to the conduct of macro-prudential oversight?

These are the themes on which I will elaborate today. In particular, I set out to convince you that, first, macro-prudential oversight has a crucial role to play in preventing financial crises; and, second, that monetary policy and macro-prudential oversight are complementary: the success of monetary policy in achieving its primary objective of price stability facilitates the pursuit of the objectives of macro-prudential oversight and *vice versa*.

## II. THE MULTIPLE CAUSES OF THE CRISIS AND THE CASE FOR MACRO-PRUDENTIAL OVERSIGHT

Before addressing these questions, it would be useful to consider briefly two issues that can help to clarify what policy-makers – and central bankers in particular – are striving to achieve with their policies aimed at protecting financial stability. The first issue concerns the concept of financial stability. The second relates to the causes of, and the other contributing factors to, the crisis and the determinants of its severity and evolving nature.

The complexity of the concept of financial stability and the challenges in specifying, in quantitative terms, the associated policy objective render an explicit definition elusive. At the ECB, we have defined financial stability as ‘a condition in which the financial system – comprising financial intermediaries, markets and market infrastructures – is capable of withstanding shocks and the unravelling of financial imbalances, thereby mitigating the likelihood of disruptions in the financial intermediation process which are severe enough to significantly impair the allocation of savings to

profitable investment opportunities'.<sup>1</sup> It is clear from this definition that the objective of promoting and safeguarding financial stability cannot be defined in terms of a single indicator in a reasonably straightforward manner, as can be done with the price stability objective. Indeed, it has been argued that it may be preferable or more useful to define financial stability as the absence of instability.<sup>2</sup>

If we assess the events of the past few years, what conclusions can we draw about the main causes of, and contributing factors to, the recent episode of extraordinary and prolonged financial instability? These causes and factors are many, complex and inter-related. At the microeconomic level, a toxic combination of a new banking model – characterised by the enormous growth of securitisation at its heart – with weak governance and inadequate risk management led to the emergence of serious incentive problems and excessive risk-taking in the financial sector. Regulators and supervisors did not sufficiently appreciate the extent of these problems. At the macroeconomic level, the emergence and persistence of financial imbalances, both globally and domestically, created new systemic vulnerabilities, which in some cases also reflected the stance of macroeconomic policies. In particular, excessive credit creation and rising leverage, in a benign macroeconomic environment of low inflation, were supported over a considerable period of time by historically very low interest rates that fostered a search for yield and encouraged risk-taking.

The severity and complexity of this crisis is the consequence, among other things, of the combined and interacting effects of those macroeconomic and microfinancial factors. For example, the excessive credit growth and marked rise in leverage was facilitated by the increasingly widespread adoption by banks of the 'originate-and-distribute' business model based on the securitisation of their assets. At the same time, the excessive credit expansion and the remarkable growth in securitisation reflected an increase in risk appetite and a mispricing of risks by banks and investors, which was supported by the very low interest rates as well as by the complexity and opaqueness of structured credit products. These interactions

<sup>1</sup> See *ECB Financial Stability Review*, June 2009, p. 9. This definition implies that the safeguarding of financial stability requires the identification of the financial system's main sources of risk and vulnerability, such as inefficiencies in the allocation of financial resources and the mispricing or mismanagement of financial risks. Other definitions of financial stability that have been proposed also reflect the inherent complexity of the concept.

<sup>2</sup> See Crockett (1997).

between the macroeconomic environment and microfinancial factors and processes contributed to the build-up of financial imbalances, and the emergence of other system-wide risks whose crystallisation affected the stability of the financial system.

A number of pertinent conclusions can be drawn from the recent experience. First, the financial crisis revealed that many financial institutions, including large cross-border banking groups, did not accurately identify and assess the nature, magnitude and consequences of systemic risks that were emerging in the economy and the financial sector, and they were not adequately prepared to absorb such risks when they materialised. Second, the sources and effects of systemic risks were not sufficiently appreciated by supervisory authorities, as their focus was on the soundness of individual financial institutions. Third, as a result of the crisis, a broad consensus has emerged in support of a macro-prudential approach to financial regulation and supervision with the aim to prevent and mitigate systemic risks.

### III. SYSTEMIC RISK AND MACRO-PRUDENTIAL OVERSIGHT

Let me elaborate on the two concepts of ‘systemic risk’ and ‘macro-prudential oversight’. Systemic risks are those risks that can threaten the functioning of the entire financial system and disrupt the financial intermediation process to such a degree that there are negative spill-over effects on the real economy. It is important to recognise that systemic risk is partly endogenous, as it depends on the collective behaviour of financial institutions and the extent to which they are interconnected, as well as on the interaction between financial markets and the broader macroeconomic environment.

The concept of systemic risk is closely linked to the notion of ‘externality’ in the jargon of economists. This means that while each financial intermediary manages its own risk appropriately, it may not take into account the impact of its actions on the aggregate risk in the financial system. For this reason, the aggregate amount of risk in the financial system can prove excessive and, owing to interdependencies, larger than the sum of the perceived risks by individual financial institutions. As a consequence, once the system has reached a certain degree of fragility, even apparently limited or localised shocks – such as the one that crystallised in the relatively small U.S. sub-prime mortgage market in mid 2007 – may trigger a disruptive chain of events.

Macro-prudential oversight focuses on the prevention and mitigation of system-wide risks and vulnerabilities. It aims at detecting and assessing sys-

temic risk by examining how aggregate risk is distributed across financial institutions and markets, and how it evolves over time. This requires identification and monitoring of common risk exposures of financial institutions, which can result from their direct or indirect exposures to similar types of risk, as a consequence of the aggregate effects of individual investment decisions or because of the inter-connections between institutions. Common exposures can be a source of contagion and a cause of simultaneous failure of institutions. Macro-prudential policies aim to prevent, or at least contain, the build-up of financial imbalances and ensure that the financial system is able to withstand their unwinding and be resilient to shocks.

Central banks are well suited to be the authorities mainly responsible for macro-prudential supervision because of their expertise and analytical capabilities in the fields of monetary analysis and financial stability analysis. Moreover, they closely monitor and assess money and financial market developments and they have a good understanding of the interlinkages between the financial system and the macroeconomy. These tasks, which are performed for the conduct of monetary policy, strengthen the rationale for assigning to the central banks the responsibility for macro-prudential analysis and the formulation of recommendations concerning macro-prudential policies.

In the European Union, we have made good progress towards the establishment of an appropriate institutional setup for macro-prudential oversight.<sup>3</sup> In October 2009 the Ecofin Council reached a broad agreement – based on a proposal by the European Commission – on two legislative proposals concerning (1) the establishment of the European Systemic Risk Board (ESRB), a new independent body that will be responsible for the macro-prudential oversight of the EU's financial system, and (2) the specific macro-prudential tasks to be assigned to the ECB, which will ensure the Secretariat and provide analytical, statistical and administrative support to the ESRB, also drawing on technical advice from the NCBs and supervisory authorities. The proposed legislation, which was extensively discussed in the European Parliament, envisages that the ECB, in collaboration with the national central banks will play a leading role in the functioning of the Board.<sup>4</sup> This is evident from the Board's composition and from the tasks to be assigned to the ECB.

<sup>3</sup> See Papademos (2009b) for a more detailed account of the European framework for macro-prudential supervision.

<sup>4</sup> Following the discussions in the European Parliament in the first half of 2010 and the opinion adopted, and after a trilogue between the Council, the Commission and the

#### IV. MACRO-PRUDENTIAL OVERSIGHT: TASKS, ANALYTICAL TOOLS AND POLICY INSTRUMENTS

What are the tasks, analytical tools and policy instruments of macro-prudential oversight? The precise tasks to be performed by the ESRB partly depend on the overall institutional setup. The ESRB will carry out several tasks. The key tasks are three: (1) identify and prioritise systemic risks in the EU; (2) issue risk warnings when systemic risks are judged to be significant; and (3) issue recommendations for remedial action in order to contain the identified risks.

The establishment of the ESRB will strengthen the financial stability framework in the EU in many respects. Firstly, it will be the first EU body responsible for risk identification, monitoring and assessment for the entire financial system in the EU as a whole. This is a major improvement, since so far financial stability assessments have been conducted mostly at the national level by central banks and supervisors or have been focused on specific financial sectors.

Secondly, the power of the ESRB to issue risk warnings and policy recommendations to supervisory authorities and other relevant policy-makers should result in concrete actions to prevent or mitigate threats to the stability of the financial system. More generally, macro-prudential oversight will help micro-prudential supervisors to better take into account conjunctural and structural developments in the financial system and the real economy in the supervision of individual financial institutions.

The tools required for carrying out the tasks of macro-prudential supervision are of two kinds: analytical tools for risk identification and assessment, and macro-prudential policy instruments. The analytical tools that can be used to identify and assess systemic risks and to issue early risk warnings include: (i) financial stability indicators to point to fragilities related, *inter alia*, to broad-based increases in leverage or to financial institutions' rising common exposures to asset classes; (ii) early warning models to indicate when the financial system, or a particular market, approaches a 'danger zone'; (iii) macro stress-testing models to assess the resilience of the

Parliament, an agreement was reached in September 2010 on a proposal for a regulation of the European Parliament and the Council on 'EU macro-prudential oversight of the financial system and establishing a ESRB'. After a vote in the plenary session of the Parliament, the final legal text was adopted by the Council in November 2010.

banking system to extreme but plausible events; and (iv) contagion models to help identify the extent to which financial sectors are interconnected.

A substantial amount of work is being carried out at the ECB and elsewhere to improve these analytical tools. As the financial system is both complex and evolving, the tools for macro-prudential analysis must be constantly evaluated and possibly adapted accordingly. Of course, the use of such indicators and models should be complemented by other information, including market intelligence; moreover, risk assessments and warnings will have to rely on the judgement of experts and policy-makers.

What are the policy instruments of macro-prudential supervision? Macro-prudential policies can be expected to require, to a considerable extent, regulatory and supervisory action. They could take the form of general guidelines or concrete recommendations relating to the calibration of prudential tools. For example, macro-prudential recommendations could involve the adjustment of minimum capital requirements or the setting of additional capital buffers in the banking system as a whole, or entail guidance regarding leverage ratios and liquidity management. Macro-prudential policies would not concern individual financial institutions but the financial system as a whole, or certain financial sectors.<sup>5</sup> While in principle a range of macro-prudential tools is available, the choice of the appropriate prudential tools to address emerging systemic risks in an efficient and effective manner will require considerable technical work. In addition, it should be stressed that the formulation and implementation of the appropriate macro-prudential policies will always require the use of judgement and common sense.

In the European Union, the implementation of the macro-prudential policy recommendations of the ESRB will be, depending on their nature, the responsibility of governments, the European Supervisory Authorities or national supervisors.<sup>6</sup> Recommendations may also be addressed to the Commission with regard to the relevant European legislation. The ESRB will not issue recommendations to individual financial institutions, since this would conflict with the responsibilities of the micro-prudential super-

<sup>5</sup> With respect to the adjustment of capital adequacy ratios, recent proposals point to adjusting the capital adequacy ratio of individual institutions according to their contribution to systemic risk or to the degree of compliance with corporate governance standards. See Brunnermeier *et al.* (2009).

<sup>6</sup> Recommendations addressed to a national supervisor will also be communicated to the relevant European Supervisory Authority.

visory authorities. Moreover, the ESRB will not make recommendations concerning the potential contribution of monetary policy to preventing and mitigating systemic risks, since this is the responsibility of independent central banks. This observation brings me to the last part of my remarks, namely the role of monetary policy in safeguarding financial stability.

#### V. THE CONTRIBUTION OF MONETARY POLICY TO FINANCIAL STABILITY

Several pertinent and important issues arise that require careful consideration. What role can monetary policy play in supporting financial stability? Could such support lead to a conflict with the achievement of the primary objective of price stability? And what is the relationship, if any, between macro-prudential oversight and the conduct of monetary policy? These are challenging questions that have been addressed extensively over the past few years in the light of the crisis. I will try to give concise answers based on the available evidence, theoretical arguments and the European institutional framework.

The ECB's objectives are clearly laid out in the Treaty. The primary objective of monetary policy is to maintain price stability. The empirical evidence accumulated over a very long period of time in many countries and the theoretical insights developed by eminent economists, make the case for assigning to an independent central bank the responsibility for using monetary policy to maintain price stability overwhelming.

The recent experience of financial crisis does not overturn this view. On the contrary, it has demonstrated that the effectiveness of monetary policy instruments relies heavily on the credible anchoring of inflation expectations at levels consistent with price stability. By firmly anchoring inflation expectations to price stability, the ECB's monetary policy has minimised the risk of deflation. Stable inflation expectations have enhanced the effectiveness of monetary policy in stabilising the economy, which is particularly relevant when nominal policy rates are very low and face a zero lower bound. Thus, while central banks may need to review and refine their policy or operational frameworks in the light of their experiences during the financial crisis, the central tenets of central bank independence and the primacy of the price stability objective for monetary policy should be reinforced, not revised.

At the same time, the Treaty on the Functioning of the European Union stipulates that the ECB 'shall contribute to (...) the stability of the

financial system'.<sup>7</sup> The Eurosystem's Mission Statement states that 'we aim to safeguard financial stability'.<sup>8</sup> An increasing body of evidence suggests that money and credit growth lie at the heart of boom and bust cycles in asset markets, which, in turn, have broader implications for financial stability, as well as for aggregate output and price developments. Asset price surges, and the resulting asset price misalignments, are typically preceded by rapid monetary and credit expansion.<sup>9</sup> Analysis of these relationships is a very active area of research at the ECB.<sup>10</sup> In the design of the ECB's monetary policy strategy, it was always foreseen that the close monitoring of monetary developments would offer a very useful basis for assessing asset price misalignments.<sup>11</sup> Recent research provides a significantly enriched framework for conducting such monitoring in a systematic fashion, and promises that asset price disequilibria and associated financial distress may be identified at an early enough stage for the policy authorities to take corrective measures.

Viewing asset price dynamics through the lens of monetary developments integrates them into an overall framework directed towards the achievement of our goal: price stability. At the same time, taking into account and responding to monetary and credit dynamics as part of a comprehensive assessment of the risks to price stability implies that interest rate decisions will effectively 'lean against' accumulating financial imbalances and asset price misalignments. Even if any such orientation cannot be translated into a mechanical policy rule, such an approach will serve both financial and macroeconomic stability, in particular price stability, especially over longer time horizons.

<sup>7</sup> Article 127(5) of the Treaty on the Functioning of the European Union and Article 3.3 of the Statute of the European System of Central Banks and of the European Central Bank state that 'the ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system'.

<sup>8</sup> See [www.ecb.europa.eu/ecb/orga/escb/html/mission\\_eurosys.en.html](http://www.ecb.europa.eu/ecb/orga/escb/html/mission_eurosys.en.html).

<sup>9</sup> See Cecchetti *et al.* (2000), Kohn (2007) and Papademos (2009a) for further arguments and analysis on the role of monetary policy in preventing a financial crisis and dealing with its consequences for the economy.

<sup>10</sup> See, among others, Gerdesmeier, Roffia and Reimers (2009), Adalid and Detken (2007), and Alessi and Detken (2009).

<sup>11</sup> For example, reference is made to such considerations in EMI (1997) in the context of a discussion of the main elements of the ECB's monetary policy strategy. See also ECB (1999) and Issing (2002).

In addition, recent research has shown that monetary policy decisions can influence bank risk-taking, thereby triggering faster credit expansion and a substantially greater easing of financial conditions than policy-makers had initially intended.<sup>12</sup> This is another channel through which monetary policy actions may impact on financial stability. Monetary policy aimed at price stability, taking account of its transmission via this risk-taking channel, would naturally tend to contain excessive bank risk-taking and/or credit expansion. Such monetary policy should also help prevent financial instability.

However, considerable work is needed to better understand these transmission channels because, if such channels are poorly understood, the danger of monetary policy mistakes rises significantly. Monetary policy therefore relies heavily on a good understanding of the behaviour of banks and the financial sector more broadly. Insights developed for this purpose are naturally of central relevance to the assessment of financial fragilities and vulnerabilities which is required in order to pursue policies to safeguard financial stability.

Thus, the preservation of price stability over the medium and longer run by monetary policy generally complements and supports the pursuit of financial stability. This statement also holds true during periods of financial stress. The non-standard monetary policy measures implemented by the ECB in recent years have contributed to financial stability by facilitating market functioning, the efficient transmission of monetary policy, and the provision of credit to the economy. Central bank intermediation has avoided that conditions of illiquidity in the interbank money market would lead to solvency problems, with adverse effects on financial stability, the real economy and, ultimately, price stability.

A monetary policy credibly pursuing the objective of price stability contributes significantly to the maintenance of financial stability. Nevertheless, past experience has also shown that there are limits to what can be achieved by relying solely on the interest rate instrument. Financial crises have usually been triggered by disruptions in specific markets, whether they are defined sectorally or geographically. Similarly, the vulnerability of sectors and regions to the impact and propagation of a financial crisis has

<sup>12</sup> See, among others, Borio and Zhu (2008), Altumbas, Gambacorta and Marques (2010), Jiménez, Ongena, Peydro and Saurina Salas (2010), and Maddaloni and Peydró (2009).

varied. Monetary policy has a broad macroeconomic impact. It is too 'blunt' an instrument to deal with the specificities and peculiarities of a financial crisis. Moreover, market excesses and the pro-cyclical behaviour of the financial system also arise from factors other than excessive credit growth and high leverage, which are related to the monetary policy stance. Consequently, other policy tools must also be employed – notably regulatory and supervisory policy instruments – in order to reduce pro-cyclicality and limit the emergence – of systemic risks in the financial system.

#### VI. THE RELATIONSHIP BETWEEN MACRO-PRUDENTIAL OVERSIGHT AND MONETARY POLICY

What is then the relationship between macro-prudential oversight and monetary policy? At the start of my presentation, I made a point about the complementarity of monetary policy to macro-prudential oversight. After discussing what macro-prudential oversight is, and after explaining that the pursuit of price stability by monetary policy complements and supports the pursuit of financial stability, I can make the point that success in preventing financial instability through macro-prudential oversight facilitates the pursuit of the price stability objective assigned to monetary policy. The latter can be achieved in various ways: by facilitating the transmission of monetary policy; by containing the propagation and amplification of macroeconomic shocks by the financial sector; and by reducing the frequency and severity of shocks originating in the financial sector itself, such as bank failures, or the abrupt unwinding of sizeable imbalances in financial markets. Thus, interactions between regulatory and supervisory policies, especially at the macro-prudential level, and monetary policy can be expected to be mutually reinforcing in preserving price stability and preventing financial instability.

At the same time, while developing effective interaction at the macro level, it will be important to maintain a clear allocation of responsibilities between monetary policy and macro-prudential supervision, while at the same time ensuring the necessary flow of information among the relevant policy-makers.

The single monetary policy has been unambiguously assigned by the Treaty the objective of preserving price stability and it is formulated and implemented in full independence. The ECB is accountable for the achievement of this objective. All this is understood by other policy-makers. By act-

ing in a transparent way consistent with its mandate, the ECB creates an environment of price stability within which other authorities can take decisions under their responsibility in order to achieve their own objectives. Experience with monetary union demonstrates that clarity of responsibilities, independence of action and accountability for decisions, in an environment of open and frank exchange of information among policy authorities, produces the best overall outcomes. This experience forms a good basis for defining and developing the institutional framework for macro-prudential oversight in Europe, given the existing – and well-functioning – monetary policy regime.

## VII. CONCLUDING REMARKS

Looking ahead, I am convinced that the complementarity of the ECB's monetary policy strategy to the new EU framework for macro-prudential oversight will contribute to enhancing crisis prevention and to strengthening the resilience of the European financial system, in an environment of price stability. We should not forget – and the crisis will not allow us to forget at least for some time – that prevention is always better than cure.

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## HOW DO WE 'REPLAN THE JOURNEY'? PANEL ON FINANCIAL MATTERS

MARIO DRAGHI

### INTRODUCTION

The financial system and the global economy look set to be on a path to recovery. This will be an uneven recovery, with Asia and Latin America growing substantially faster than Europe and North America, each of which must address large fiscal challenges in the years ahead.

Uneven growth will see the resumption of large cross-border capital flows. Flows into emerging market economies are projected to rise strongly, on account of their sounder fundamentals and growth. However, the flows from emerging to advanced economies will also be significant: advanced countries need them to finance accumulated debt.

In part as a result, the important global payments imbalances that preceded this crisis will remain. Indeed, the IMF forecasts that the modest unwinding seen during the recent crisis is unlikely to continue. The persistence of imbalances, and hence the ongoing accumulation of large net foreign liability positions, has the potential to put the global economy at risk.

This much is well recognized, and multilateral efforts are under way to reduce imbalances: for example, the G20 Framework for Growth announced at the Pittsburgh Summit. These efforts focus on a policy-induced rotation of demand: from domestic consumption to exports in current account deficit countries, and from exports to domestic sources of growth in surplus countries.

This is important. But efforts to achieve this rotation are not new, and we should not hold our breath for quick results.

An unwinding of payments imbalances necessarily involves changes in financial flows. And adjustments in the capital account can occur disturbingly quickly – forcing a rapid turnaround of demand that has very high economic, financial and social costs. This is the situation in Greece

today. There are other countries around the world that, in the absence of precautionary adjustment, are prone to similar risk.

The costs of a forced adjustment are too high to accept. And yet a policy-induced switch of demand will take time to achieve. So what can be done in the meantime to reduce the probability and impact of a sudden swing in capital flows?

We must persist with the agreed agenda for strengthening the financial system. Financial sector reforms will help to contain the risks associated with large and at times volatile capital flows. Indeed, financial regulatory reforms are a precondition for strong and sustainable global recovery. Moreover, our experience is that the more opaque a financial system is the more fragile it is. We must address both the lack of transparency and the lack of robustness.

#### FINANCIAL REFORM AGENDA

The recent financial crisis, like so many earlier financial crises, was the result of excessive and misperceived levels of debt and perverse incentives to take on risk. Financial institutions failed to price risks appropriately, and their supervisors failed to understand the risks to which these institutions were exposed. Financial institutions created and invested in opaque products that they did not understand, and leveraged their balance sheets to acute levels. In the U.S., the SEC's relaxation in 2004 of pre-existing limits on leverage for investment banks increased the complexity of their risk management. The large volume of issuance of collateralized obligations by a few players increased both the market power of these players over the credit rating agencies and their dependence on this source of revenue. The market for complex products, including the rapidly growing CDS market, was concentrated in a relatively small number of major financial institutions.

We know what needs to be done to improve the pricing and the management of risks, and the development of policies designed to achieve this are well advanced, led by the Financial Stability Board. We now need to move quickly to implement these policies. In particular, they need to be implemented globally because risk is now priced and traded at a global level.

First, capital and liquidity frameworks need to be materially strengthened. Market participants and regulators overestimated the true degree of risk dispersion and diversification and, as a result, mispriced a whole range of risks. When mispriced risks are re-priced, they reveal that the capital and liquidity cushions that support the risk-taking are not nearly enough to

absorb the damage. The Basel Committee on Banking Supervision will deliver a fully calibrated package of reforms by the end of 2010, which will be phased in carefully: the level and quality of bank capital will be increased; liquidity buffers will be enlarged.

Second, and closely related, the procyclicality of the financial system needs to be reduced. Financial institutions tend to underestimate risks during booms and overestimate them during busts. While the causes are complex, procyclicality can be reduced through changes in prudential and accounting rules, and the implementation of macroprudential policies. For example, banks can be required to build up capital buffers during good times that can be drawn down during periods of stress, to recognize early losses and make provisions against them. The FSB is moving initiatives forward to reduce procyclicality in all of these areas.

Third, moral hazard needs to be addressed. Moral hazard clearly contributed to the mispricing of risk prior to the crisis. Instead of exercising due diligence, investors relied on implicit guarantees when investing in structured investment vehicles, or housing-related securities, or bank securities. It is an even bigger problem now, after the exceptional government interventions in support of financial institutions, and the FSB attaches high priority to reforms to address too-big-to-fail institutions. Policies in this area include the establishment of effective resolution mechanisms and the reduction of the interconnectedness of institutions by moving OTC derivatives to central clearing.

While reforms of the financial sector will improve the pricing of risks, they will certainly not eliminate mispricing. There are many sources of possible pricing distortions, which might contribute to the build-up of imbalances. When these imbalances eventually unwind, the financial system should be a source of stability, not a source of shocks. Clearly that has not been the case in recent years. That is why strengthening the shock absorption capacity of the financial system is an absolute priority.

Some say that we need to postpone these reforms, to avoid derailing a fragile recovery. I respond that the recovery is too fragile to permit forbearance. Large payments imbalances remain with us, and gross capital flows are set to expand greatly in the years ahead. The possibility of a sudden reversal is high, as the situation in Greece demonstrates. If economic conditions deteriorate and we have not reformed the financial system, then we will face the risk of a renewed downward spiral. Options for further monetary and fiscal easing are limited – in some cases almost non-existent. The resilience of the financial system is thus critical to the sustainability of the recovery.

## ASPETTI FINANZIARI DELLA CRISI E PROSPETTIVE

ETTORE GOTTI TEDESCHI

A parte una brevissima premessa, proporrò una mia interpretazione dell'origine della crisi. È un'interpretazione che non è la prima volta che ho occasione di discutere, però desidero anticiparvi un'interpretazione che è messa sempre in discussione perché ha motivazioni di carattere morale. Poi parlerò dello sviluppo di questa crisi, riprendendo in malo modo quello che ha già detto Mario Draghi. Poi farò una brevissima conclusione.

Quando sentiamo parlare di questa crisi, molto spesso in sintesi abbiamo l'impressione che ci sia stato uno scontro tra una finanza globale e regolamenti (invece) domestici. Normalmente qualcuno ci mette anche la "magia", legata a prodotti finanziari più o meno sofisticati. Come diceva Giovanni Paolo II nella *Sollicitudo rei socialis*, l'uomo ha degli strumenti molto sofisticati in mano, ma non ha più la saggezza, la competenza e la maturità per gestirli, per cui gli sfuggono di mano.

In realtà, io ho un'interpretazione, perlomeno sull'origine, che è lievemente diversa. Io non credo che l'origine sia stata lo scontro tra una finanza globalizzata e, diciamo, sistemi invece periferici e domestici di controllo. L'origine della crisi per me – lo affermo anche con un tono abbastanza provocatorio – nasce col crollo della natalità. Il crollo della natalità, tra il 1968 fino agli anni 80, provoca crescita zero della popolazione. La crescita zero della popolazione ha un effetto sul crollo dello sviluppo, perché lo sviluppo del PIL, se la popolazione non cresce, può essere solo nella crescita dei consumi pro capite. Così si cerca di compensare il crollo dello sviluppo utilizzando degli strumenti che normalmente sono strumenti più o meno *schumpeterianamente* logici o, a volte, illogici. Ricordo la tesi del Professor Ehrlich, della Facoltà di Biologia dell'Università di Stanford, che nel 1968 scrisse *Il boom demografico* prevedendo centinaia di milioni di morti di fame (in Asia soprattutto) prima del 2000 se la popolazione fosse continuata a crescere. Successivamente l'MIT, Massachusetts Institute of Technology, con il Club di Roma, ridimensionò un poco le stime che aveva fatto

Ehrlich. L'MIT e il Club di Roma corressero un poco le previsioni di Ehrlich, portando le centinaia di milioni di persone a qualche decina di milioni di persone che sarebbero morte di fame. Ricordiamo cos'è successo: tra il 1975 e gli anni 80 il tasso di crescita popolazione, che era stato negli ultimi 10 anni intorno al 4-4,5%, nel mondo occidentale scende progressivamente a zero. Tra l'80 e l'85 il tasso di crescita e lo sviluppo della triade economica, cioè del mondo occidentale, Europa, Stati Uniti e Giappone, crolla di 4-5 punti percentuali e il mondo comincia a preoccuparsi. Cosa fa il mondo che si preoccupa? Anzi, meglio, di cosa si preoccupa? Voi sapete che, se la popolazione non cresce, ci sono due fenomeni che immediatamente appaiono: prima aumentano i costi fissi, e questo è semplice da capire perché la struttura della popolazione invecchia, ci sono meno persone che entrano nel ciclo produttivo a produrre e più persone che escono e che vanno a costare per pensioni, sanità etc. L'aumento dei costi fissi provoca immediatamente un fenomeno conseguente, che è la difficoltà a ridurre le tasse, anzi, le tasse aumentano. Nel 1975, nel nostro paese, il peso fiscale sul prodotto interno lordo era del 25%: nel 1995 va al 35% e oggi è superiore al 45%. Poi c'è un altro fenomeno estremamente interessante. Quando crolla il tasso di natalità, crolla il tasso di crescita degli asset finanziari, incomincia a decrescere il tasso di accumulazione del risparmio.

Come viene compensato, nel mondo occidentale, questo crollo della crescita, dovuto al crollo della natalità? Attraverso tre interventi di carattere economico estremamente logici, vi dicevo prima, *schumpeteriani*. Il primo è maggior produttività. È ovvio, no? Se una famiglia deve aumentare il suo potere d'acquisto e il suo PIL, cosa fa il papà? Va a fare gli straordinari. Gli straordinari sono stati equivalenti alla *net technology*, una maggiore produttività, ma la maggiore produttività non è stata sufficiente a compensare l'esigenza di budget che doveva crescere per assorbire anche un andamento molto ciclico delle spese belliche. Le spese belliche sul PIL nel mondo nordamericano sono passate dal 14% al 4% alla fine della guerra fredda e sono ritornate a crescere a ritorni consistenti dopo l'11 settembre. Un paese importante come gli Stati Uniti non può permettersi di avere un crollo del tasso di crescita del prodotto interno lordo. Perciò ha dovuto sostenerlo. La delocalizzazione è stata il secondo modello per sostenere la crescita del PIL è un fenomeno estremamente interessante. Incomincia circa 20 anni fa con il trasferimento in Asia di una certa serie di produzioni a cosiddetto basso costo. Il processo di delocalizzazione, che è stato, secondo me, strategicamente mal gestito dal mondo occidentale, ha permesso sì all'Asia di accrescere rapidissimamente il suo tasso di sviluppo e diventare un'area geogra-

fica che ha accelerato il tasso di sviluppo. Noi attraverso la delocalizzazione abbiamo permesso all'Asia di diventare ricca, però noi non abbiamo definito nessuna strategia industriale ed economica del mondo occidentale. Questi due processi, quindi soprattutto maggior produttività e delocalizzazione, hanno sì compensato in parte il crollo dello sviluppo che era legato al crollo della natalità, ma non in maniera sufficiente. Che cosa è stato quindi necessario fare per compensare definitivamente quest'esigenza di crescita? Spingere il consumismo a debito. Questo è un punto fondamentale signori, chiunque di noi può aumentare, di fatto, per un periodo di tempo breve, il suo PIL, basta che qualcuno gli dia dei soldi e lui possa indebitarsi e spendere. Inizia quindi un fenomeno che progressivamente arriva, come spiegava prima il nostro Governatore Mario Draghi, agli eccessi dei cosiddetti *sub-prime* che hanno portato ad una situazione che vi voglio mostrare con due grafici interessanti che spiegano in maniera molto chiara, secondo me, che cos'è successo negli ultimi dieci anni. Guardate questo: questo qui è il debito del "sistema". Che cos'è il debito di un "sistema"? Quando noi pensiamo al debito di una nazione, normalmente pensiamo al debito pubblico, però il debito di un sistema non è debito pubblico, è debito pubblico, debito privato, debito delle industrie e debito delle istituzioni finanziarie. Questi quattro debiti fanno il debito di un sistema e, come tali, vanno valutati nel loro tasso di crescita. Guardate (Fig. 1), nel 1998 il debito del sistema Italia (che è curiosamente più o meno uguale a quello degli Stati Uniti) era il 200% del PIL e arriva nel 2008 a diventare il 300% del PIL, cioè aumenta del 50%. È interessante notare che il peso, su questo debito totale del sistema, il peso per l'Italia del debito pubblico equivale al peso, negli Stati Uniti, del debito delle famiglie, circa il 33-35%. Fatto uguale a 100 il debito del sistema, le famiglie negli Stati Uniti hanno lo stesso peso del debito che ha in Italia il debito pubblico. Questo è interessante rilevarlo perché spiega il diverso modello di recovery tra USA e Italia. La prima sta nazionalizzando il debito privato (insostenibile) mentre l'Italia sta privatizzando il debito pubblico.

Adesso vi faccio vedere un altro grafico (Fig. 2) che spiega la situazione negli Stati Uniti. Nel 1998 il peso del debito delle famiglie americane sul prodotto interno lordo era del 68%. Arriva nel 2008, dieci anni dopo, al 96%. Vedete la crescita a debito consumistico tutta posta sulla famiglia. Quanto vale questa crescita sul prodotto interno lordo? Vale 28 punti percentuali, dal 68 al 96%. Se io divido, in maniera molto grezza, 28 per 10 anni, io ho il 2,8% all'anno, diciamo circa un 3%, cioè su 3,2-3,5 di tasso di crescita medio americano in dieci anni, il 90% è dovuto all'indebitamento delle famiglie americane.

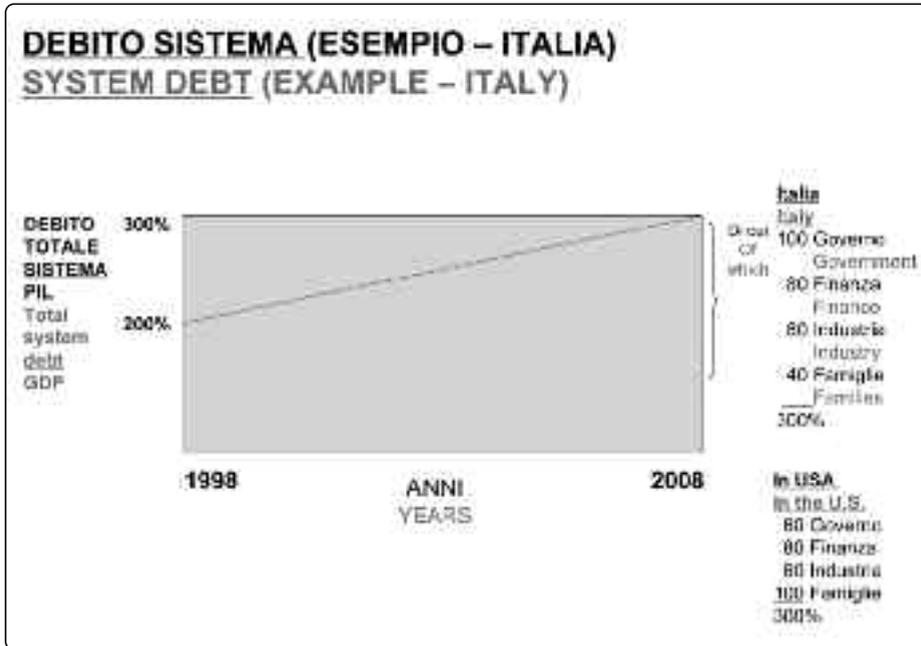


Fig. 1. Fonte/Source: McKinsey.

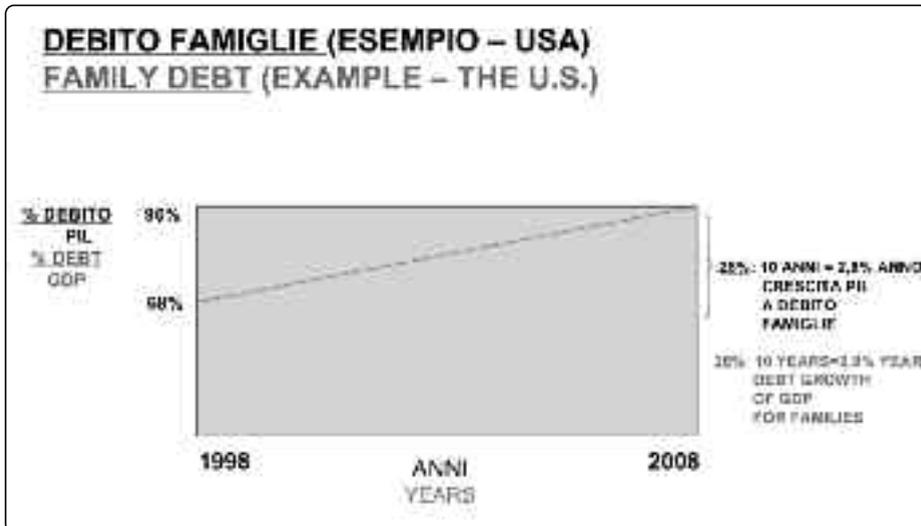


Fig. 2. Fonte/Source: BCG.

Riguardo le banche, non voglio ripetere quello che ha detto il nostro Governatore, evidenzio solo un fenomeno. Il rapporto impieghi sui capitali propri passano dalle 12 volte del 1998 fino a 30 volte nel 2008, in dieci anni (Fig. 3), il che è anche comprensibile, evidentemente. Qualcuno i soldi doveva tirarli fuori... Che cos'è la conseguenza di tutto questo? La conseguenza di questo gonfiamento enorme del debito è un'esposizione molto forte, un'esposizione che sta in piedi soltanto perché teniamo i tassi zero, perché se no gli stati dovrebbero pagare degli interessi alti, le famiglie dovrebbero pagare interessi più alti, l'industria e così via e tutti dichiarerebbero default. I tassi si tengono bassi, ma i tassi bassi sono un'ingiustizia e non sono supportabili per molto tempo, perché un tasso zero significa trasferimento di ricchezza da chi è stato virtuoso, cioè da chi ha generato risparmio (che ovviamente viene penalizzato) a chi è indebitato e non solo, i tassi zero provocano evidentemente anche stimoli alla speculazione. Che cosa bisogna fare quindi in questo momento? Il modello, con un termine anglosassone di quello che stiamo facendo e che dobbiamo fare si chiama *deleveraging*, cioè sgonfiamento, dobbiamo sgonfiare il debito. Ma lo sgonfiamento non sarà uguale negli Stati Uniti, in Europa e in Asia, sarà completamente diverso, ognuno adotterà un suo modello, in funzione di cosa?

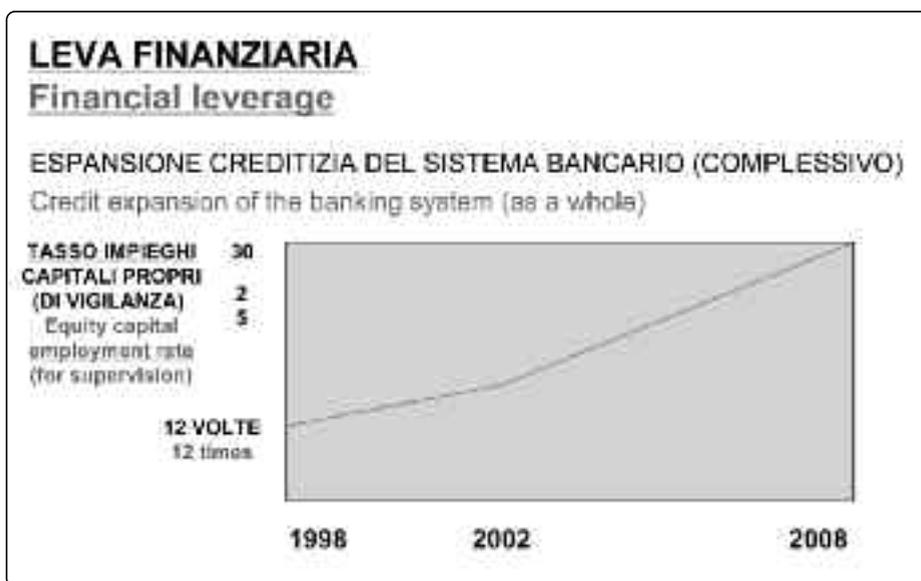


Fig. 3.

Innanzitutto in funzione di dov'è il debito. Negli Stati Uniti il debito è soprattutto nelle famiglie, quindi è comprensibile che sulle famiglie non si possa fare più di tanto. Infatti negli Stati Uniti chi sta guidando il tentativo di ricrescita non è di sicuro il privato, è il governo americano. Che cosa succederà non lo so. In Asia, per esempio, il fenomeno è completamente inverso. In Asia, in questo momento, addirittura, se fosse possibile, si cercherebbe di ridurre il tasso di sviluppo portandolo dal 12-13% ad un 7%, perché il terrore è che nasca un fenomeno di inflazione che poi non sia più controllabile. Ma se l'Asia smettesse di comprare, di produrre, il mondo occidentale crollerebbe in questo momento, quindi è anche difficile immaginare che si possa rallentare la crescita asiatica. In Europa il fenomeno è completamente diverso e anche diverso al proprio interno. Quali sono i quattro modi con cui normalmente si fa un *deleveraging*? (Fig. 4) Sono: il modello Argentina, un default (speriamo di no); il modello americano, una bolla (in Italia non so che bolle si possano fare, l'unica bolla che conosco in Italia è la bolla immobiliare); l'inflazione, ecco, questo è un fenomeno che invece



Fig. 4.

noi conosciamo abbastanza bene e l'abbiamo già adottato. Voi vi domandate ma, se è vero che la liquidità è aumentata del 50% in dieci anni, perché non è scoppiata l'inflazione? Signori, l'inflazione non è fatta dalla massa monetaria sui beni, ma è massa monetaria per velocità della moneta sui beni e la velocità è zero. Il denaro, non circola, per questo l'inflazione è bassa. Paradossalmente, se il sistema bancario ricominciasse a intermediare, come intermediava prima, l'inflazione probabilmente scoppierebbe.

C'è anche una quarta strada, che si chiama austerità, che probabilmente è quella che dovremo adottare noi in Italia, in Europa, però in un paese maturo come l'Italia, l'austerità potrebbe essere un fenomeno che dura molto tempo. Non dimentichiamo che noi siamo paesi maturi. Cosa vuol dire un paese maturo? Voi sapete che cosa fa la capacità competitiva di un paese? Competitiva dal punto di vista economico-industriale? Sono tre fattori a farla: o si hanno bassi costi, o si ha tecnologia più o meno alta o adeguata, o si hanno dei prodotti unici. Noi abbiamo alti costi, non abbiamo mai fatto grandi investimenti tecnologici, e i prodotti unici non sono più tanto difendibili come erano una volta. Conseguentemente, per noi, riadattare un modello strategico non sarà facilissimo.

La situazione delle banche. Dopo che ha parlato il Governatore sarò estremamente cauto e molto prudente in quello che dirò. Le banche, secondo me (da molti punti di vista) hanno perso un po' di credibilità, cioè hanno dimostrato di non saper fare molto bene il loro mestiere e quindi, conseguentemente, la fiducia nella loro capacità di riprendersi è sicuramente crollata, soprattutto ci si domanda se abbiano saputo gestire il rischio. Ora potrebbero dover pagarne gli errori e gli errori come si pagano? O si fanno super utili, o ci si ricapitalizza, o ci si fonde, o ci si ristruttura – ristrutturazione tra l'altro sia nel management che nelle attività di business – ma soprattutto nell'azionariato. Non sarà facile però farlo, non sarà facile perché i volumi diminuiscono, proprio per l'effetto di *deleveraging*. Le banche da qualche parte devono guadagnare, dove guadagneranno? Non lo so, forse continueranno nelle commissioni... Comunque, minor crescita dei volumi, i capitali non facilmente disponibili, e in più i più alti rischi. Avete sentito poco fa quello che ha detto Mario Draghi, i rischi stanno aumentando, cioè, per risolvere i problemi provocati da rischi passati sottostimati si va a prendere più rischio e, conseguentemente, si aggrava potenzialmente ancora di più la situazione. In più c'è il problema della delocalizzazione dei servizi. Abbiamo delocalizzato le produzioni, potrebbe essere in atto un processo di delocalizzazione addirittura dei servizi. In più ci saranno nuovi organismi di controllo, che impatteranno le scelte delle banche. Non abbia-

mo soltanto lo *stability board*, abbiamo altre 23 nuove strutture (poi non so se sono proprio 23), comunque ci sono molte strutture e questo che cosa potrebbe provocare? Provocare una nuova regolamentazione dei mercati, innanzitutto nuovi *ratio* di capitali. Secondo, nuove regole di trasparenza, terzo punto, nuove *governance*, che probabilmente potrebbero essere considerate rigide, o perlomeno meno motivanti il *management*.

Le conseguenze che si prevedono sono, innanzitutto, è ovvio, cambierà la gestione del rischio, cambierà l'impatto del ROE, *return on equity*, e quindi del valore di borsa, cambieranno sicuramente il modo di consolidare la competizione domestica, aumenterà moltissimo la ristrutturazione dei costi. Voi pensate, in Italia oggi abbiamo una capacità produttiva inutilizzata di circa il 25%, infatti abbiamo un tasso di disoccupazione intorno al 10-10,5% che, corretto dalla cassa integrazione, va all'8,6 ufficiale. Che cosa facciamo? Noi non possiamo cercare nuovi mercati di sbocco, perché le imprese italiane per più del 50% esportano in Europa, soprattutto in Germania e in Inghilterra, e altri paesi di sbocco non è facile trovarli. Che cosa succede? Che le imprese hanno soltanto una strategia: riduzione costi, ricerca di efficienza. Ricerca di efficienza e riduzione dei costi vuol dire disoccupazione, o perlomeno sicuramente non vuol dire nuova occupazione. Ecco quindi che si ritiene corretto e auspicabile che sia lo stato ad intervenire in qualche modo, che siano opere infrastrutturali, che siano incentivi, ma temo non si possa prescindere in questo momento, da un intervento a supporto dell'economia da parte degli stati.

Conclusione: io credo, come dicevo prima, che ci aspetti un periodo di austerità. Il credito bancario sarà una risorsa più scarsa e più costosa, perché le banche, nell'ottica di *delevereggiare*, di sgonfiare il loro indebitamento, saranno molto più selettive. Da un punto di vista competitivo la strategia della banca è quella di cercare tutti gli spazi possibili di mercato da occupare, profittare delle debolezze supposte o vere dei propri competitori e andare a competere in tutti i mercati, anche in quelli emergenti, ovviamente tornando anche a quello che si può chiamare, nel nostro mondo, *back to basics*, a cercare soprattutto di ridurre i costi. Il problema delle imprese italiane è che non solo hanno meno risorse finanziarie ma anche loro dovrebbero ricapitalizzarsi, e come fanno a ricapitalizzarsi? Per riuscire a ricapitalizzarsi dovrebbero essere più trasparenti nella definizione delle loro strategie. Dovrebbero garantire una determinata gestione del rischio e una nuova *governance*. Quindi è possibile e prevedibile che sia lo Stato ad aumentare la sua presenza nel sistema economico.

Grazie.

# PERSONNES ET FAMILLES DANS UN CONTEXTE D'INCERTITUDE

ROLAND MINNERATH

## I. LA CRISE

La crise financière et économique qui se prolonge depuis deux ans a mis en évidence la distance grandissante entre les pratiques de la vie économique et la vision que développe la Doctrine sociale de l'Eglise. La crise n'est pas seulement liée à quelques dysfonctionnements. Rien n'a d'ailleurs été corrigé. La sphère financière reprend son autonomie vis-à-vis de l'économie réelle. Le problème est dans la place qu'occupe l'économie dans le système social et partant, dans les mentalités. L'économie est malade parce qu'elle est devenu le tout de la vie sociale et de la vie tout court.

Nous avons subi les conséquences d'un système qui se dérègle parce qu'il échappe à tout contrôle. Nous avons aussi constaté que ce dérèglement est dû à la recherche de profits financiers à tout prix, sans contrepartie dans l'économie réelle. Ces pratiques ont mis à nu les limites d'un système où l'économie est l'horizon englobant de l'existence, soumettant à ses exigences la vie sociale et politique, c'est-à-dire la sphère où s'exerce normalement une activité volontariste des hommes dans la maîtrise de leur destin.

La seule maîtrise sur le système dérégulé de la finance mondiale a été l'intervention massive des Etats venus au secours des banques et de quelques grandes entreprises en faillite.

Ce qui s'est passé a mis à mal la théorie dominante du libéralisme économique, puisque le marché globalisé se voulait libre de toute ingérence des Etats et prétendait être en mesure de se réguler lui-même. Il a aussi montré les limites des conceptions anthropologiques sous-jacentes à cette conception de l'économie, à savoir l'individualisme forcené qui met l'individu sans liens ni obligations au centre de la toile du marché. La crise a été un naufrage du libéralisme absolu et un naufrage de l'individualisme post-moderne.

La notion même d'individu est en contradiction avec la conception catholique de la personne. L'individualisme postmoderne, quant à lui, est incompatible avec la notion de famille. Personne et famille sont selon la pensée catholique, deux données de la nature créée par Dieu et sont donc irréductibles à toutes les dérives conceptuelles et à toutes les déformations pratiques qu'on peut leur faire subir.

On peut soutenir que la personne et la famille sont absentes de pratique économique contemporaine, malgré les efforts de nombreux auteurs de les réhabiliter en théorie.

## II. L'ÉCONOMIE DANS LA DOCTRINE SOCIALE DE L'ÉGLISE

Qu'il me soit permis de rappeler d'un mot la place que l'économie tient dans la Doctrine sociale de l'Eglise. L'économie n'est pas le tout de la vie et de l'homme. L'économie est une activité que les hommes doivent organiser selon des principes éthiques pour la mettre au service de la personne humaine. Ce n'est pas le système économique, quel qu'il soit, qui prime sur l'homme et ses besoins incompressibles. L'économie est cette dimension du bien commun qui doit être permise à toutes les personnes et à leur famille de vivre de leur travail et de contribuer au progrès intégral de tous les membres de la société.

La Doctrine sociale de l'Eglise place l'économie au rang des moyens pour atteindre l'objectif éthique qu'est le développement intégral de la personne humaine et du bien commun, les deux étant indissociables. La personne n'est pas réductible à son activité économique. Le bien commun ne se réduit pas à sa dimension économique. L'économie est située dans le champ de la responsabilité des personnes et des sociétés par rapport au bien commun. L'économie n'est pas une sphère autonome qui imposerait sa loi muette à la responsabilité politique chargée du bien commun.

L'économie doit mettre en œuvre deux paramètres et pas un seul seulement: la liberté d'entreprendre qui est une requête de la dignité de la personne et de ses associations ; et la gouvernance de l'économie par la fixation de priorité de développement et le contrôle de légalité de ses activités.

Le progrès n'est pas seulement matériel, il englobe tous les autres éléments qui entrent dans la vision d'une vie conforme à la dignité humaine. Dans la pensée catholique, personne et bien commun ne sont pas dissociables. Dans la pensée néo-libérale, l'individu est un centre d'appétits égoïstes. Il n'est pas membre d'une communauté dont il reçoit tous les élé-

ments qui lui permettent de vivre, et au progrès de laquelle il est appelé à contribuer. Il est un concurrent des autres. Il conçoit sa liberté comme une liberté de se soustraire aux contraintes de la vie en société, non comme une liberté de participer à l'aventure commune.

### III. PERSONNES ET FAMILLES DANS L'ÉCONOMIE

La personne est par sa nature un être social. Le bien commun, c'est le bien de la personne en tant que membre de la société. Il n'y a pas de concurrence entre le bien de la personne et le bien commun. Le bien commun c'est l'ensemble des conditions qui permettent à la personne de se réaliser en tant que personne. Il n'y a pas de valeur sociale supérieure à la personne.

Or la personne naît dans une famille, est éduquée dans une famille. La plupart des personnes exercent leur activité économique comme membres d'une famille.

Je n'ai pas besoin d'insister sur l'abîme qui sépare la conception catholique de la famille de celle qui prévaut sous l'idéologie du genre. Le projet de tous les totalitarismes est de détruire la famille, pour régner sans partage sur les personnes. L'idéologie du genre est un fruit de l'individualisme absolu qui n'admet pas de réalité reçue de la nature. Toute réalité serait création de la volonté humaine.

Nous avons devant nous un panorama plutôt diversifié de couples non mariés, des couples unis par un pacte de solidarité, des couples mariés, divorcés remariés, des familles dites monoparentale, des unions homosexuelles qualifiées quelquefois de mariages, avec ou sans droit d'adoption; beaucoup de familles recomposées. Pour nous, la famille fondée sur le mariage stable et l'accueil des enfants est la cellule naturelle inviolable de la société. Elle n'est pas un produit de la culture et de la société, mais une donnée. Donc la vie en société, en particulier l'économie, doit être ordonnée de telle sorte qu'elle permet l'épanouissement des personnes dans leurs familles.

Lorsque la Doctrine sociale de l'Église parle de la famille, elle est bien consciente que le modèle de la famille stable reposant sur la fidélité des époux est devenu rare dans la culture occidentale, même s'il y apparaît encore comme un idéal désirable. Si donc nous nous demandons quel est le comportement des personnes et des familles dans l'environnement économique incertain que nous connaissons, nous sommes bien conscients que nous décrivons un idéal plus qu'une réalité empirique.

On peut soutenir que le mépris de la personne entraîne le mépris de la famille, et que le mépris de la famille livre la société à l'empire du marché

et de la recherche désordonnée du lucre pour le lucre. Nous savons que la société sans référence à l'éthique est prête à se livrer à l'idéologie, qu'elle soit collectiviste ou ultra-libérale.

Si l'on se place du côté de ce que l'économie devrait être, dans la vision de la Doctrine sociale de l'Église, il apparaît que les personnes et les familles ont un rôle primordial vis-à-vis de l'activité économique.

Le volume de travail fourni par une personne ou un groupe ne se résume pas au travail rémunéré. Le travail domestique représente une part importante de la charge de travail d'un ménage. Elever ses enfants à la maison est un travail qui a une portée sociale. Ce type de travail échappe aux comptabilités publiques et au PIB.

Le travail salarié d'une personne doit lui permettre de vivre décemment ainsi que sa famille. Les prestations familiales accordées aux familles nombreuses, les mesures fiscales sont des aides indirectes à ce que l'on appelait le "salaire familial".

Notre collègue le Prof. Stiglitz dans son rapport sur la mesure du développement économique et du progrès social, a relevé ces insuffisances en ajoutant que les personnes ont une perception différentes des réalités que mettent en lumière les statistiques habituelles. Les mesures du PIB rendent mal compte des coûts environnementaux, de la distribution des revenus et des richesses ainsi que des inégalités qui sont voilées derrière les simples moyennes.

Les besoins de la personne ce sont les besoins qui personnalisent, qui rendent autonome et préparent les hommes et les femmes à se prendre en charge. Les besoins de la famille sont ceux qui permettent aux familles d'exister. N'oublions pas que le déclin de la famille au sens large vers la famille père-mère-enfant est dû aux conditions de vie urbaine et à l'industrialisation. Le déclin de la famille, le nombre croissant de ménages célibataires ou monoparentaux sont dus à la difficulté de trouver un logement rapproché du lieu de travail. La vie dans les grandes villes a rompu tous les réseaux qui humanisaient les familles et les préservaient de l'isolement et de l'aliénation de l'anonymat. L'habitat, les techniques de communication, les médias, l'idéologie dominante, tout porte vers l'individualisme. La famille est dénigrée, même lorsqu'elle apparaît comme un refuge. C'est l'individu qui est courtisé par le marché, non la famille.

Pourtant, c'est dans la famille que l'être humain commence à se réaliser. La plupart des biens de consommation sont des biens qui s'adressent aux familles. L'économie de consommation, en misant sur l'individu, contribue à marginaliser les familles. La famille est le lieu où une alternative pour une économie du don, de la gratuité et du développement intégral peut prendre corps.

#### IV. DES CHOIX ÉCONOMIQUES CONFORMES À L'ÉTHIQUE

Plusieurs thèmes semblent liés à la question du comportement des familles dans la vie économique. Du point de vue normatif que décrit la Doctrine sociale de l'Église, il paraît urgent d'en retenir trois:

1. La personne et ses choix économiques. La personne devrait être considérée sous l'aspect de ses besoins fondamentaux. Ceux-ci sont énumérés dans les grandes Déclarations de droit: la vie, l'éducation, la nourriture, le logement.

Que voyons-nous? La pauvreté dans les pays en développement comme dans les pays développés touche surtout les femmes et les enfants. Vivant dans des conditions précaires, des enfants ne peuvent avoir un développement normal, dans des logements exigus, privés de sommeil, de nourriture, d'affection. Le marché n'a pas été capable de répondre à ces besoins élémentaires.

2. Sous l'empire du marché-roi, des cibles de consommateurs de plus en plus précises ont été identifiées. Il s'agit de vendre aux enfants, puis aux adolescents, ce qu'ils désirent. Ces désirs sont eux-mêmes suscités par les médias. On a relevé que les jeux électroniques, les baladeurs, les blogs sur internet visent surtout des individus isolés. Peu de jeux de société ou d'activités collectives sont l'objet de promotions. La technologie électronique isole les jeunes des autres et de leur famille. Bref, la production se règle en fonction des désirs qu'elle suscite.

Or les jeunes ont besoin de relations structurantes avec leurs parents, leurs enseignants, leurs camarades. L'éducation doit les former non à la satisfaction de tous les désirs, mais à la responsabilité en société. On nous dit que les jeunes lisent moins, ne savent plus l'orthographe, se construisent des relations fictives par leurs *chats*, alors qu'ils ignorent leur voisin le plus proche.

L'enfant à naître est lui-même devenu un enjeu économique. Il est planifié pour le moment où il cause le moins de gêne pour la vie professionnelle de la mère, ou du père ou des deux. L'enfant est éduqué à la consommation facile. On ne lui refuse rien pour avoir la paix. Il consomme des images et des programmes de télévision. Il est virtuose d'internet, des blogs interactifs. Il paraît qu'il exige de porter des sous-vêtements de marque et qu'il juge ses camarades en fonction de leur habillement. Il est formaté pour être un consommateur d'idées sur mesure, de *fastfood*, de produits en vogue.

Si l'économie n'est pas le moteur premier de la vie sociale, l'enfant ne doit pas être l'otage des stratégies commerciales.

3. Il faut affirmer avec force que le développement économique selon l'éthique du bien commun n'est pas concevable sans la participation des

familles. La personne doit trouver sur le marché ce qui manque à sa croissance humaine et qu'elle peut s'offrir. Or le marché flatte l'ego, non la personne. Nos produits se vendent non en fonction de leur utilité réelle mais de la charge symbolique qui leur est attachée. Les spécialistes du marketing le savent bien. Une économie centrée sur la personne devrait permettre à des considérations de sobriété et non seulement d'image de revenir au premier plan.

L'économétrie n'enregistre que les éléments du PIB. Elle ne prend pas en compte les activités économiques non commercialisables, en particulier les services domestiques. On se contente de parler d'économie parallèle, englobant des activités aussi disparates que le bénévolat, le marché noir illégal et les services domestiques. Il est cependant indéniable que le travail domestique participe à la création de la richesse, non seulement matérielle, mais aussi immatérielle comme l'ordre et la paix sociale. Les services ne sont comptabilisés que s'ils sont rémunérés. Les services échangés à l'intérieur d'un ménage ne sont pas des productions enregistrées par le PIB. L'activité domestique des ménages intéresse l'analyse de la consommation, pas de la production.

4. La famille est-elle simplement une institution non marchande, ou est-elle créatrice de richesses? A partir des années 1970, des économistes s'intéressent à l'économie domestique. La mesure est le temps consacré aux activités intra familiales ou ménagères. Il s'agit d'activités par ailleurs indispensables. Le travail produit une valeur d'usage sans valeur extrinsèque (d'échange). On leur a donc attribué des prix fictifs. Les activités domestiques sont des substituts marchands de l'activité rémunérée. Elever des enfants est un investissement qui suppose des coûts initiaux élevés, mais des développements futurs incommensurables.

Les personnes et les familles sont aussi présentes dans la société par leur activité associative. L'activité associative bénévole développe des initiatives essentielles pour corriger les inégalités sociales, contribuer à la promotion humaine des plus démunis, créer du lien social. Elles sont l'expression d'une économie du don, compris comme échange non marchand, de savoir-faire, de formation, de réinsertion dans la vie sociale.

5. Dans la perspective du développement durable et de l'écologie, les décisions de la génération active hypothèquent la vie des générations à venir. On le voit pour la gestion des ressources de la planète et pour la dégradation de l'environnement. De même les politiques budgétaires structurellement déficitaires, solutions de facilité à court terme, sont désastreuses pour l'avenir. La solidarité intergénérationnelle exige que l'on ne fasse pas peser sur les générations montantes les conséquences de la mauvaise gestion de ceux qui les précèdent.

L'approche du tout le domaine social par la personne et le bien commun est un rempart sûr contre la domination de l'idéologie. Aujourd'hui nous voyons deux types d'idéologie s'ériger en système englobant: le culte de la biodiversité et celui du développement durable. Les impératifs de respect de la vie sous toutes ses formes et de développement respectueux de l'environnement et de la nature sont devenus, dans de nombreuses prises de position de nouveaux Léviathan auxquels il faut sacrifier la personne humaine et sa dignité inaliénable. Ainsi le respect de la vie devient un culte de la vie en général, sans distinction du règne végétal, animal et humain. Les humains sont perçus comme des prédateurs de leur environnement, il faut donc en surveiller la croissance démographique, en limiter le nombre, au nom de la Terre ou de la Vie.

Nous sommes aux antipodes du paradigme biblique sur lequel la civilisation occidentale a vécu jusqu'ici. A savoir que Dieu a fait le monde pour le confier à l'homme créé à son image pour qu'il le cultive et le garde (*Genèse 2,17*). L'homme et la femme sont les coopérateurs de Dieu pour l'achèvement, le développement, le perfectionnement de la création. Ils ne sont pas des créatures quelconques puisqu'ils sont les seuls à être doués de pensée et à pouvoir entretenir comme il convient des rapports humanisants avec leur environnement, en le respectant sans s'y soumettre pour autant comme à une nouvelle idole.

Le rapport à l'économie est tout autre si on considère que l'économie est au service de la société et que la société est au service de la personne humaine.

Le but de l'économie est de permettre d'utiliser des ressources rares pour satisfaire des besoins humains. Le système doit être efficace: il doit permettre de satisfaire de vrais besoins sans gaspiller les ressources. Si tel est l'objectif, le marché ne peut être le seul régulateur entre ressources et besoins. Il faut le marché encadré par l'éthique. L'éthique c'est l'humain qui prend le dessus sur la position du plus fort qui oriente ses investissements, ses recherches, sa carrière uniquement en fonction de son intérêt privé et non de l'intérêt général. L'éthique n'est pas un discours extérieur par rapport au marché. Elle doit s'y inscrire. Mais l'éthique n'est pas non plus l'écho des intérêts sectoriels ou d'idéologies politiques. Elle nous met devant le fait de la non satisfaction des besoins élémentaires de beaucoup d'êtres humains alors que des richesses inouïes sont créées et distribuées entre ceux qui sont déjà largement pourvus.

## CONCLUSION

L'attention portée ici à la personne et aux familles est le fruit d'une démarche éthique. La crise économique et financière a été un baromètre du mépris de l'éthique conçue comme devoir de donner à chaque homme la possibilité de satisfaire les besoins élémentaires que réclame la dignité humaine.

Nous avons bien dit que l'économie a vocation de créer des richesses. Il n'est pas question de céder à l'idéologie d'une masse limitée de biens à partager, bref à généraliser la pénurie. Il n'est plus possible de valider la théorie selon laquelle tous les besoins solvables, y compris ceux qui procèdent des désirs subjectifs les plus futiles, sont des moteurs pour l'économie et contribuent à créer des richesses. L'éthique exige que tous les humains accèdent aux conditions de vie qui protègent leur dignité. Le marché doit donc être orienté vers la satisfaction des besoins de nourriture, de santé, de logement, d'éducation pour tous, avant d'engloutir ses ressources en intelligence, capital et matières premières dans des actions qui laissent la masse des hommes au bord de la route.

La compétence de l'Eglise est d'ordre éthique. Elle s'adresse donc à la conscience et au jugement des personnes. Aux personnes et aux familles d'intérioriser les valeurs et d'adopter les comportements qui seront susceptibles de changer leur rapport à l'économie. Si l'économie prend sa racine dans les comportements des personnes et des familles, elle peut être réorientée selon les critères éthiques inscrits dans le cœur de tout homme et que nous appelons la loi naturelle. Celle-ci demande que l'activité de production et de consommation n'oblitére pas tout le champ de la vie humaine, mais qu'elle soit organisée de telle sorte que les besoins humains fondamentaux soient satisfaits en priorité et que chaque personne puisse faire vivre sa famille de son travail.

ETHICS AND ECONOMICS, OR HOW MUCH EGOISM  
DOES MODERN CAPITALISM NEED?  
MACHIAVELLI'S, MANDEVILLE'S, AND MALTHUS'S  
NEW INSIGHT AND ITS CHALLENGE

VITTORIO HÖSLE

Clearly, the current economic crisis has many causes, most of which are institutional: experts have cited private overspending, a speculative bubble in the real-estate market, insufficient capital requirements for banks, the formation of oligopolies in the banking sector due to its lack of anti-trust legislation, capital flows no longer under the control of traditional national states, the limited liability of managers, and an engagement in activities that were too risky due to bonuses that were based on short-term instead of long-term profits as contributing factors. But on all of these issues the scholars here present are incomparably more competent than a mere ethicist like me could ever be. Still, a philosophical perspective can be useful: after all, institutions mirror agreements on values, and they can only survive because there are people acting within them. Every human action, however, is driven not only by interests, which are shaped by background institutional arrangements, and by the desire for recognition, but also by values. Values can be analysed in two ways: either from the outside, as by psychologists and sociologists, or from the inside, as by ethicists. The former speak in the third, the latter in the first person on what is right; the former describe, the latter prescribe values. Yet even ethicists have to be aware of the fact that both values and ethical theories have changed over time, and therefore every ethicist is well advised to have a theory of why a plurality of ethical theories has developed over time. One might call it a philosophy of the history of ethics. What I want to offer in the following reflection is, first, a contribution to such a philosophy of the history of ethics: I shall explain some of the changes in the basic ethical concepts that have brought forth modernity. For there is little doubt that the natures not only of moral

sensibilities but also of ethical concepts have become quite different in modernity from what they were in antiquity and the Middle Ages. Modern capitalism thrives on these changes, and we can neither understand its spirit nor that of its critics if we do not understand their different ethical starting points. Much of the resentment against capitalism that can be found today in traditional societies has to do more with the perception that it changes deeply rooted beliefs about values than with the economic disadvantages that it inflicts on some strata of the population. The former success of Marxism can hardly be attributed to Marx's limited economic insights – which were, to a large degree, already outdated when the two last volumes of *Das Kapital* were published posthumously, given the rise of neo-classic economics and its new answer to the value problem. It was Marx's outrage at what he perceived as the hypocrisy of bourgeois mores that proved attractive and compensated for the weakness of his economic theory, and there is little doubt that any economic crisis of the magnitude that we have witnessed in the last years will elicit some form of moral indignation, the nature of which it is important to understand. Toward this purpose, I will focus on the most provocative justification of capitalism ever offered, that by Bernard de Mandeville. My choice is motivated not only by the fact that two economic theorists as diverse as Marx<sup>1</sup> and Hayek<sup>2</sup> sincerely admired this intellectual, who wrote at a time when economics was still a branch of philosophy and ethics – a link severed only in the 19th century. It seems to me that the unleashing of neoliberalism in the last few decades was – not exclusively, but partially – accompanied by the reemergence of a Mandevillian spirit. On the basis of this historical analysis, I will then try to offer some reflections on why capitalism cannot rest on egoism alone.

## I.

The historian of ethics is well advised to insert his story of the moral justification of modern capitalism into a broader context. For modern capitalism does more than just presuppose the rise of the modern state: the

<sup>1</sup> Karl Marx/Friedrich Engels, *Werke*, Bd. 23: *Das Kapital. Kritik der politischen Ökonomie*, Erster Band, Berlin: Dietz, 1962, 643: 'Mandeville, ein ehrlicher Mann und heller Kopf'. On p. 375, Marx points to his influence on Adam Smith.

<sup>2</sup> Friedrich August Hayek, *Law, Legislation and Liberty*, Vol. 1, Chicago: University of Chicago Press, 1973, 20, 22, 29. Mandeville and Hume are praised as the discoverers of phenomena due to human actions but not to human design.

moral arguments that helped to liberate capitalism in the eighteenth century were anticipated for the first time in the context of justifying said modern state. It is a fortuitous and amusing coincidence that the names of three of the most radical modern innovators on moral questions begin all with 'Ma'; this permits us to speak jokingly of the moral revolution caused by the three Mas. I have in mind Niccolò Machiavelli (1469-1527), Bernard de Mandeville (1670-1733), and Thomas Robert Malthus (1766-1834). But what is common to these three people beside the alliteration of their names? After all, none of them was a professional ethicist, they wrote on different topics (politics, economics, and demography), and they belong to diverse ages and nations: their lifespans stretch from the fifteenth century to the nineteenth century and they come from different countries – Italy, the Netherlands, and the United Kingdom (even if Mandeville emigrated from the Netherlands to England after completing his study of medicine and wrote mostly in English). Still, it is not difficult to recognize that they offer the same basic ethical insight, and that this insight is something new compared to both ancient and medieval ethics. This insight characterizes the predicament of modernity in both Catholic and Protestant countries – even though it took longer to apply the new principle to that most intimate realm, reproduction, than to economy. Politics was the new principle's first home: here the principle has an obvious intuitive force (Machiavelli taught only political theorists, not princes themselves, new lessons) since the view of the politician it legitimates is more in tune with the traditional appreciation of royal behavior; ambition was regarded by the pre-modern tradition as less problematic than greed or lust. But what is this disquieting new insight? Our three authors agree in recognizing that some sort of behavior – once regarded as virtuous and for which they partly continue to have, and partly only pretend to have, a nostalgic sympathy – leads to negative consequences, while the opposite behavior – which partly the tradition, and partly they themselves, condemn as vicious – can be beneficial to society at large. This is linked to the modern discovery that human behavior may well have unintended consequences – consequences that not only the social theorist but also the ethicist is well advised to study.<sup>3</sup> Since intentionality is the

<sup>3</sup> Of course, people have known from time immemorial that individual actions may have unintended consequences, but that whole habits, shared by the majority and regarded as virtuous or vicious, may create a social world with its own logic and which must be evaluated in a very different way than the habits from which it stems, is a novel insight.

essence of spirit, those human forces that determine our behavior in a blind, irreflexive way become particularly important for the study of man, and thus the seventeenth and eighteenth centuries abound in theories of passions – which, many authors teach, can only be checked by countervailing passions, not by a practical reason deemed increasingly powerless. Albert Hirschman has masterfully analyzed the development of these theories and the transformation of the concept of passion into the concept of interest.<sup>4</sup> By subjecting the passions to some long-term end, interest made human behavior calculable and predictable and thus less dangerous.

If I return to this history, I do it with a specific interest in the nature of their *ethical* argument. Their discoveries were intellectually exciting but also probably emotionally painful to all three authors, although both Machiavelli and Mandeville – particularly the latter – hide their unease behind cynicism. But it would be wrong to overlook their moral seriousness: they do not invite humans to engage in behavior that most people still regarded as repulsive simply because this will increase their individual profit; no, their argument transcends personal interests and is oriented towards the common good. This makes their stance an ethical one, despite the sarcasm they occasionally show, and distinguishes them from ancient immoralists, such as Thrasymachus in Plato's *Politeia* or Calicles in his *Gorgias*, whose position cannot, and does not seek to, be universalized. Let us look at the basic moral idea in the three most popular works of our authors.

Machiavelli's exhaustive political philosophy is laid out in the *Discorsi sopra la prima deca di Tito Livio*, but his most widely read book is the short treatise *Il principe*. I cannot discuss here how Machiavelli's defense of principalities is compatible with the staunch republicanism, which he lays out in his main work and which makes him one of the most democratic authors in the history of political thought between the Romans and the eighteenth century. Suffice it to remark that Machiavelli seems to believe that only in certain historical epochs – namely, when nations have been corrupted to their cores – do princes become inevitable and are thus to be accepted as the lesser evil.<sup>5</sup> But I have to ignore this here, as I do his classification of the various types of principalities. What is of interest is his deliberate inversion

<sup>4</sup> Albert Hirschman, *The Passions and the Interests. Political Arguments for Capitalism before Its Triumph*, Princeton: Princeton University Press, 1977.

<sup>5</sup> For a comprehensive interpretation of Machiavelli's political and historical thought, see Gennaro Sasso, *Niccolò Machiavelli*, 2 vols., Bologna: Il Mulino, 1992.

of the tradition of the mirrors of princes, particularly in chapters fifteen through eighteen of *Il principe*. This genre, already to be found in classical antiquity in authors such as Xenophon and Seneca, enjoyed great popularity in the Middle Ages: monks often wrote such mirrors, such as Smaragdus de Saint-Mihiel's *Via regia* of 813 or Aquinas' *De regimine principum*; in 1516, shortly after Machiavelli, Erasmus wrote his *Institutio principis Christiani* for Charles, King of Spain and, later, emperor. While these mirrors taught the princes Christian virtues, the disturbing originality of Machiavelli's book consists in the message that the *good* prince, at least, should not have all of these virtues. On the contrary, he should display some character traits that the Christian tradition has sharply condemned, and he should do so not only in order to preserve himself but also in order to foster the interest of his polity. For only strong states can secure the thriving of their people by warding off the danger that civil unrest and attacks from other countries represent; in order to achieve this end, the prince is permitted, even obliged, to develop habits that the tradition declared vicious. It is necessary for a prince who wants to maintain his position to learn to be able to be not good, Machiavelli writes (15.1).<sup>6</sup> 'Good' here can hardly mean 'behaving according to duty': the necessity about which Machiavelli writes is not a hypothetical one. He does not say that 'if you want to maintain power, you will have to behave in a way that is immoral', suggesting that the latter is inadmissible and that therefore one should give up the quest for power. The whole thrust of the book, and the reflections anterior to this passage, which criticize the mere imagination of polities that have nothing to do with the bleak reality of human nature, point in the opposite direction: Machiavelli thinks that an intelligent holder of power is entitled, even morally obliged, to dispense with goodness: the necessity of which he speaks has a deontic flavor. And this entails, under the pain of self-contradiction, that 'goodness' does not mean 'right behavior' but rather a behavior only so called because it manifests itself in kindness and benevolence – which, however, are not always morally commendable. This becomes clear at the end of the chapter, where Machiavelli states that it would be a wonderful thing if in a prince all the virtues commonly so called could be united; but, since this is impossible, the prince should always avoid the rep-

<sup>6</sup> 'Onde è necessario a uno principe, volendosi mantenere, imparare a potere essere non buono'. I quote the book according to: Niccolò Machiavelli, *Il Principe*, Milano: Rizzoli, 1986, 147.

utation of having those vices that would endanger his position. He should also avoid the other vices, if possible; when impossible – that is, when incompatible with the preservation of power – he should accept them. This probably<sup>7</sup> shows that Machiavelli recognizes that those vices have a negative intrinsic value; however, their positive consequences for the preservation of power outweigh that value. And thus he ends the chapter with these words: ‘One will find something that will look like virtue but, if followed, will lead to his ruin, and something else that will look like vice but, if followed, will lead to his security and prosperity’.<sup>8</sup>

Traditional virtues are thus demoted to the realm of merely apparent values if they are detrimental to self-preservation. This seems to be a merely egoistic criterion for defining true virtue, but Machiavelli soon shows that what he has in mind is the interest of the people. Among the traditional virtues he demotes are liberality, clemency, and faithfulness, of which the second enjoys a particular prestige in Christianity. His arguments against a prince who is a spendthrift and thus will soon be obliged to raise money from his subjects are quite easy to follow and more a challenge of courtly values, particularly of what ethicists from Aristotle onward praised under the title of *megaloprepeia* (munificence), than of the legitimate moral ideas of the emerging bourgeois world, which Machiavelli surreptitiously proposes to Lorenzo de’ Medici, the prince to whom he dedicates his book. More disturbing is his defense of ‘crudeltà’, even if it is misleading to translate the term as ‘cruelty’, for today the English and the Italian terms seem to imply a pleasure in inflicting pain on other people, while Machiavelli has in mind only toughness against those who challenge the prince’s power. But the decisive argument for this conclusion is that Cesare Borgia through his toughness was able to pacify Romagna, while Florence, desiring to avoid the reputation of being tough, refused to deal forcefully with the civil unrest in Pistoia in 1501, which led to much more bloodshed.<sup>9</sup> What Machiavelli rejects is, in any case, the inconsistency of praising, on the one hand, the military discipline that Hannibal upheld, while, on the other hand, condemning the severity without which such discipline would quickly evapo-

<sup>7</sup> I say ‘probably’ because Machiavelli might have in mind the utility of their mere appearance to the people, of which he speaks later (18.4: ‘parendo di averle, sono utili’ (157)).

<sup>8</sup> ‘si troverrà qualche cosa che parrà virtù, e seguendola sarebbe la ruina sua, e qualcuna altra che parrà vizio, e seguendola ne riesca la securtà e il bene essere suo’ (148).

<sup>9</sup> 17.1 (151 f.); cf. *Discorsi* III 27.

rate.<sup>10</sup> Machiavelli's attack against the virtues of the traditional mirrors of princes thus does not lack all moral substance. He measures the moral value of a policy by its utility for the prince's own polity, transcending the prince, but not his polity. A universalistic ethics is alien to him; therefore, he can defend munificence as long as it is at the expense of conquered nations.<sup>11</sup> Furthermore, Machiavelli does not claim that the person who engages in tough behavior is always motivated by the right motive: the prince may well be driven only by his own desire for power – to which, in fact, Machiavelli himself appeals in broaching his novel topic to the addressee of his treatise. But Machiavelli will have regarded himself as morally justified in appealing to the will to power of a prince if, by doing so, he was to bring about positive consequences – such as the liberation of Italy from foreign rule for which he pleads at the end of his book.

I hope the foregoing reflections make it clear why Machiavelli is important in the history of not only political theory but also that of ethics proper. Perhaps we could say that, since Machiavelli, ethicists have become aware of the scary possibility that the canon of virtues, of both the ancient and the Christian traditions, is not necessarily consistent.<sup>12</sup> Even if we cherish the intrinsic value of all these virtues, we have to reckon with the possibility that they may have negative consequences that contradict the purposes that other virtues, and perhaps even these virtues themselves, want to reach. We thus face the dilemma that intrinsically attractive behavior may be deleterious, while repulsive behavior – even behavior motivated by abhorrent motives – may be socially far more useful. It would be worthwhile to show how this new insight soon pervades also the greatest literature of the time, even that of an author like Shakespeare who shares in the demonization of Machiavelli peculiar to the Elizabethan age. His King Henry VI is a pious and profoundly good person, but as king he is a disaster: his weakness causes a civil war for which he has the moral dignity to feel responsible.<sup>13</sup> His father Henry V, on the other hand, is a morally complex character, but the toughness with which he hangs his old fellow Bar-

<sup>10</sup> 17.4 (154).

<sup>11</sup> 16.3 (150).

<sup>12</sup> This is the rational core of Isaiah Berlin, 'The Originality of Machiavelli', *Against the Current*, London: The Hogarth Press, 1979, 25-79, even if he wants to defend the more far-reaching and untenable claim that all ethical systems are inconsistent.

<sup>13</sup> Henry VI/3, 2.5., v. 1 ff.

dolph who has pillaged a French church<sup>14</sup> maintains discipline in the troupe and would have been hailed by Machiavelli as truly virtuous. Similarly, Cervantes's Don Quixote is driven by noble motives, yet, at least at the beginning of his story, the real consequences of his actions are very harmful, as poor Andrés has to experience (I 4). But in the process of writing his novel, Cervantes altered his original purpose, for at the end of the first part, Don Quixote proves to be an extraordinarily beneficial person; still, it is only a strange series of seemingly fortuitous, perhaps providential events that makes the hidalgo able to be more than a good person, namely, to cause good consequences in the world.

Real life is something else, and therefore the seventeenth and eighteenth centuries defend a new ethos that is quite different from that of medieval monks and knights. People understood quickly that the changes in the value system brought about by capitalism were in tension with traditional Christian virtues. Symptomatic of this understanding are reflections, in the first years of the eighteenth century, by Pierre Bayle<sup>15</sup> as well as the following remark in Jonathan Swift's masterful satire *An Argument to Prove that the Abolishing of Christianity in England May, as Things Now Stand, Be Attended with Some Inconveniences, and Perhaps not Produce Those Many Good Effects Proposed Thereby* of 1708. This work limits itself to the defense of nominal Christianity, since real Christianity is incompatible with the spirit of the new time: 'To offer at the restoring of that [sc. real Christianity], would indeed be a wild project: it would be...to break the entire frame and constitution of things; to ruin trade, extinguish arts and sciences, with the professors of them; in short, to turn our courts, exchanges, and shops into deserts...'.<sup>16</sup> Swift continues a tradition of Christian criticism of modernity, which achieved a certain peak in the Jansenist movement, and, in fact, Mandeville, the most radical defender of capitalism in the early eighteenth century, draws upon Jansenist sensi-

<sup>14</sup> Henry V, 3.6, v. 100 ff.

<sup>15</sup> *Reponse aux questions d'un provincial*, Troisième partie, Ch. XXVI ff., in: Pierre Bayle, *Oeuvres diverses III*, Hildesheim: Olms, 1966, 972 ff. The *Reponse* was published from 1704 to 1707. Mandeville studied in Rotterdam, where Bayle, who clearly influenced him, taught – 'but we do not know whether they met' (E.D. James, 'Faith, Sincerity and Morality: Mandeville and Bayle', in: *Mandeville Studies*, ed. by Irwin Primer, The Hague: Martinus Nijhoff, 1975, 43-65, 44).

<sup>16</sup> Jonathan Swift, *Abolishing Christianity and Other Essays*, San Francisco: Manic D Press, 2006, 30.

bilities when he develops his own anthropology and ethics.<sup>17</sup> Therefore, some of his earlier interpreters<sup>18</sup> have taken his profession of moral rigorism seriously, even if a careful reading makes it very likely that his pious remarks, for example at the end of *An Enquiry into the Origin of Moral Virtue*, are only the screen for a more cynical attitude.<sup>19</sup> But it is the cynicism of a man frustrated by humankind: apparently, Mandeville lowers man to the level of animals because he is outraged at human cruelty towards animals (I 173 ff.). While the Jansenists declared it a moral duty to return to the austerity of the original Christians, Mandeville only gestures at this position in order to have more freedom to outline his own vision of man. When he writes that nothing renders a person more glorious than voluntary poverty, cheerfully accepted, one feels that there are some relics of sincere fascination for such a behavior, but Mandeville, first, does not think that it occurs very often even among Christian clergy, and, second, he has the suspicion that it may be more motivated by obstinate vanity than by greatness of soul (I 157). Like the Jansenists, Mandeville sees modern society driven by egoistic drives. However – and this is the fundamental difference – he is willing to pay this moral price, one he regards as necessary for economic success. What he does not tolerate is the moral hypocrisy that wants to have the cake and eat it too, enjoy economic progress and pretend that it is still inspired by Christian values. Mandeville remains indebted to the Jansenists because he rejects the alternative view, defended by Anthony Cooper, Third Earl of Shaftesbury, that our nature is constituted by both selfish and altruistic affections that somehow harmonize with each other. This position is classically formulated in the Augustan age by Alexander Pope in the last two verses of the

<sup>17</sup> See Jennifer Herdt, *Putting on Virtue. The Legacy of the Splendid Vices*, Chicago/London: University of Chicago Press, 2008, 268. This excellent book discusses Mandeville immediately after the Jansenist Pierre Nicole and La Rochefoucauld, for, 'paradoxically, the Jansenist critique of false worldly virtue could contribute to the marginalization of Christian charity and to a forthright concentration on human nature and its social expression'.

<sup>18</sup> In his commented bibliography, Hector Monro, *The Ambivalence of Bernard Mandeville*, Oxford: Clarendon, 1975, 274-278 mentions several such works, e.g., Lafcadio Hearn, *Some strange English literary figures of the eighteenth and nineteenth centuries*, Tokyo: Hokuseido 1927. Monro's own interpretation renders justice to Mandeville's multifaceted personality.

<sup>19</sup> This has been proven by F.B. Kaye in his masterful introduction to: Bernard Mandeville, *The Fable of the Bees: or, Private Vices, Publick Benefits*, 2 vols, Oxford: Clarendon, 1924, I xvii-cxlv. I quote according to this edition.

Third Epistle in his *Essay on Man*: 'Thus God and Nature link'd the gen'ral frame,/ and bade Self-love and Social be the same'. In fact, the second part of Mandeville's book consists of six dialogues, the main interlocutors of which, Horatio and Cleomenes, are inspired by Shaftesbury and Mandeville respectively (II 20); it ends with the refutation of Shaftesbury, who 'labour'd hard to unite two Contraries that can never be reconcil'd together, Innocence of Manners and worldly Greatness' (II 357). According to Mandeville, humans are driven by passions; but while even Hume would agree with this viewpoint, Mandeville goes on to insist that these passions are basically selfish (I 200) – the rest merely deception, in the best of cases self-deception. But we can still be happy in such a world, for the unleashing of human greed must favor economic and social progress.

Mandeville's most famous work is built around 200 doggerel couplets published in 1705 under the title *The Grumbling Hive: or, Knaves turn'd Honest*. In 1714, the text was reissued, together with twenty lengthy *Remarks* in prose and *An Enquiry into the Origin of Moral Virtue*, under the comprehensive title *The Fable of the Bees: or, Private Vices, Publick Benefits*. The work continued to be expanded until, in 1729, it received a second volume containing the dialogues aforementioned. From 1724 onward, it was attacked by theologians and ethicists and was even presented as a public nuisance by the Grand Jury of Middlesex; in France, it was ordered to be burned by the hangman.<sup>20</sup> In 1732, an anonymous poet wrote about Mandeville: 'And if *God-Man* Vice to abolish came,/ Who Vice commends, *Man-Devil* be his name'.<sup>21</sup> Indeed this Man-Devil, like Machiavelli, commends what the tradition had rejected as vice – again, not simply because this is in the interest of the individual, but, on the contrary, because these private vices generate public benefits. The bees prosper, because they are vicious: 'Thus every Part was full of Vice,/ Yet the whole Mass a Paradise' (I 24). The poem shows that the worst possible would occur if the knaves turned honest and reduced their needs to the level ascribed to the golden age. In such a case, the prices of land and houses would immediately fall and economic activities would slow, for content is 'the Bane of Industry' (I 34). Such a new hive would not be able to withstand repeated attacks by stronger enemies, and thus it would have to withdraw from the world: 'They flew into a hol-

<sup>20</sup> Kaye, *op. cit.*, I cxvi.

<sup>21</sup> *The Character of the Times delineated...Design'd for the Use of those who...are convinc'd, by Sad Experience, that Private Vices are Publick and Real Mischiefs*, London: J. Wilford, 1732, 10.

low Tree,/ Blest with Content and Honesty'. (I 35) If anyone wants to avoid this result, he is well advised to accept the vices of luxury and pride – and even of fraud, since that creates jobs for lawyers ('nothing less can thrive,/ Than Lawyers in an honest Hive', I 28). Therefore, 'The Moral' at the end teaches: 'Fraud, Luxury and Pride must live,/ While we the Benefits receive' (I 36). In the *Remarks*, Mandeville gives concrete examples: without drunkenness, wine-merchants would have fewer profits, and without burglars, smiths would suffer heavy losses (85 f.). Prodigal heirs do a service to the economy by creating jobs, and poverty is needed to motivate people to work (I 193 f.). Whoever defends frugality 'shews himself a better Man than he is a Politician' (I 104; cf. 125 ff.). Mandeville rejects the idea that only luxury goods are morally problematic, since according to him all goods, or none, are luxury goods. 'People may go to Church together, and be all of one Mind as much as they please, I am apt to believe that when they pray for their daily Bread, the Bishop includes several things in that Petition which the Sexton does not think on' (I 108).

As Machiavelli dislikes the inconsistency of praising military discipline but rejecting the severity that ensures it, so Mandeville exhorts his reader to choose between a good and honest and a great and wealthy society (I 223). Whoever wants to render his subjects rich must know that he cannot have them virtuous. This does not mean that the wise politician should simply allow all passions to unfold; his task consists in regulating them in such a way that they are turned to a good end: 'Whoever would civilize Men, and establish them into a Body Politick, must be thoroughly acquainted with all the Passions and Appetites, Strength and Weaknesses of their Frame, and understand how to turn their greatest Frailties to the advantage of the Publick'. (I 208) Mandeville does not deny that the vices have to be directed in order to become beneficial: 'So Vice is beneficial found,/ When it's by Justice lopt and bound'. (I 37) As is well known, Mandeville has several economic insights that contributed to the collapse of mercantilism: he understood, for example, that 'the Fruits of the Earth, and the Labour of the People...are a more certain, a more inexhaustible and a more real Treasure than the Gold of *Brazil*' (I 197 f.), that the hoarding of money within a country will not help it, and that strengthening exports without allowing for corresponding imports cannot work (I 108 ff., 251). In general, the thrust of his economic philosophy is to increase economic freedom, which will regulate itself.<sup>22</sup>

<sup>22</sup> Robert B. Ekelund and Robert F. Hebert, *A History of Economic Theory and Method*, New York: McGraw-Hill, 1975, 42 f. praise him as 'philosophical harbinger of liberalism'.

Even if Adam Smith disliked him, Mandeville anticipates his belief in the invisible hand and is relieved that the economy does not have to appeal to virtues in order to work: 'For unhappy is the People, and their Constitution will be ever precarious, whose Welfare must depend upon the Virtues and Consciences of Ministers and Politicians' (I 190).

Nevertheless, Mandeville is completely aware of the fact that trade can only function, if there is an 'Administration of Justice, wisely contriv'd, and strictly executed' (I 116). He recognizes that, when 'Offices of the greatest Trust are bought and sold; the Ministers that should serve the Publick, both great and small, corrupted, and the Countries every Moment in danger of being betray'd to the highest Bidders', such a situation cannot work: 'These are indeed terrible things' (I 115). But it is politics, not economy, that represents the real danger (I 117). Of course, this account leaves the question open of whence justice in politics comes from. How is it possible that some people restrain from the satisfaction of their immediate interest and do not betray their duty to the highest bidder, provided they do not run a serious risk of being punished? Mandeville tries to give a genealogical account of the evolution of our moral ideas, anticipating many of the ideas of Vico and Nietzsche. At the beginning, he teaches, there was a division between two classes of people, one surrendering to all of their passions, the other aiming at self-control and thus empowering itself to rule over the first. The experience that other persons' immediate satisfaction of their drives could be quite a nuisance to oneself led to giving the name of virtue 'to every Performance, by which Man, contrary to the impulse of Nature, should endeavor the Benefit of others, or the Conquest of his own Passions, out of a Rational Ambition of being good' (I 48 f.). In order to stabilize this disposition, society brought forth a system of honors and flattered those who manage to develop virtue: 'Moral Virtues are the Political Offspring which Flattery begot upon Pride' (I 51). Pride is socially useful, for it is what motivates selfish misers to leave their estates to charitable institutions (I 264 f.). But if Mandeville takes enormous pride in examining himself as one ought (I 84) and unmasking one's pretended virtues, does he not contribute to the collapse of this result of social evolution? When he calls honor 'a Chimera without Truth or Being, an Invention of Moralists and Politicians' (I 198), does he not invite people to get rid of it? He himself mentions with a certain

On Mandeville's connection with the Whigs, whose ideology he at the same time subverts, see Maurice M. Goldsmith, *Private Vices, Public Benefits: Bernard Mandeville's Social and Political Thought*, Cambridge: Cambridge University Press, 1985, 78 ff.

melancholy sympathy Don Quixote, who still felt more obliged than entitled by his concept of honor (I 199). But are those who now understand honor as nothing more than the refusal to suffer any affront, i.e., any legitimate criticism, not closer to Mandeville's wisdom than the hidalgo?

I mentioned at the beginning that the same type of argument that we find in Machiavelli and Mandeville can be found also in Malthus. There is one important difference, however, between the earlier and later thinkers. Malthus, who was an Anglican minister, in the first edition of *An Essay on the Principle of Population* of 1798 does not explicitly favor any change in the traditional canon of virtues, as Machiavelli and Mandeville do. His point is merely descriptive, but, like them, he describes an alternative between virtuous behavior that leads to misery and vicious behavior that avoids it. His main idea, as is well known, is directed against the optimistic philosophy of history endorsed by Nicolas de Caritat marquis de Condorcet and William Godwin, who, in view of the enormous scientific progress of the seventeenth and eighteenth centuries and the French Revolution respectively, saw humankind in the grip of an irresistible progress. Malthus, on the other hand, insists that all of the increase in economic productivity will be counteracted by demographic growth, which occurs in geometric progression, while increase in food production can, as he erroneously assumed, happen only in arithmetic progression. But I am not interested here in the details of his argument, which can be disconnected from this last assumption. According to Malthus, there are two checks to population growth: a preventive one and a positive one. The first consists in limiting the number of births – e.g., by renouncing or delaying marriage. Malthus insists that this is inevitably connected to vice, by which he must mean extramarital sexual activities including prostitution and a limitation of births by various means: 'The effects, indeed, of these restraints upon marriage are but too conspicuous in the consequent vices that are produced in almost every part of the world, vices that are continually involving both sexes in inextricable unhappiness'.<sup>23</sup> These vices could only be avoided by early marriages and the willingness to have as many children as can be born. Yet, the consequences of this behavior are deleterious, for inevitably the other, the positive check will operate: 'I believe it has been very generally remarked by those who have attended to bills of mortality that of the num-

<sup>23</sup> Thomas Robert Malthus, *An Essay on the Principle of Population and A Summary View of the Principle of Population*, Harmondsworth: Penguin, 1986, 92.

ber of children who die annually, much too great a proportion belongs to those who may be supposed unable to give their offspring proper food and attention' (93). Malthus, I repeat, does not at all explicitly endorse what he calls 'vice', as later Malthusians will do; but in 1798, he thinks that humanity will inevitably oscillate between the poles of 'misery and vice' (103). Only in the second edition of 1803 does he introduce a third check, moral restraint, which seems to be his solution to the dilemma described: postponement of marriage and reduced sexual activities within the family. However, Malthus challenges traditional Christian teaching as early as 1798 regarding one issue. As Mandeville had done in his scathing criticism of Christian charity in *An Essay on Charity and Charity-schools* (I 253 ff.), Malthus, who would soon become professor of history and political economy, criticizes Pitt's poor laws. He recognizes that they 'were undoubtedly instituted for the most benevolent purpose, but there is great reason to think that they have not succeeded in their intention' (100). Malthus is not only afraid that they destroy any sense of independence and responsibility; he also fears that they only increase the problem they are supposed to heal by encouraging the poor to reproduce: 'It possesses in a high degree the great and radical defect of all systems of the kind, that of tending to increase population without increasing the means for its support, and thus to depress the condition of those that are not supported by parishes, and, consequently, to create more poor' (101).

Machiavelli, Mandeville, and Malthus have contributed to the decline of our moral respect for certain traditional virtues, and thus of behavior inspired by them, by pointing out the negative consequences that can attend clemency in the political realm, temperance and charity in the sphere of economy, and the desire to have a large family on the demographic level. By obliging us to look at the negative consequences of virtues – the intrinsic positive values of which they do not really deny – *they have rendered our moral evaluation more complex and difficult, for we now have to weigh the intrinsic and the extrinsic values of certain attitudes against each other*, and there is no algorithm for doing so. At the same time, they would not have been so successful had they not offered an enormous relief to the shapers of modernity: *By pointing likewise to the positive consequences of behavior of which the tradition disapproved, they have decreased the moral pressure on humankind, for they suggest that these vices may well be allowed to flourish, since they will prove beneficial in the end*. This is of particular relevance in the case of the economic realm. We may disapprove of greed, but if there are good reasons to believe that under certain conditions unleash-

ing it may prove more effective in overcoming poverty than any realistic alternative, we should not worry too much about it. If we accept the pessimistic Augustinian view of human nature, a view appropriated and deepened by both Protestantism and Jansenism, there is indeed relief in the insight that the economy is partly a self-regulatory system and that therefore appeal to goodness is not necessary. 'It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest', Adam Smith famously wrote,<sup>24</sup> herein agreeing with Mandeville. The doctrine of the invisible hand, which Smith also shares with his forerunner, also renders it less necessary to believe in the integrity and wisdom of politicians, which mercantilism had to presuppose.<sup>25</sup> Some theorists could even think that the transformation of private vices into public benefits is a sign of divine providence, and, while Mandeville hardly means this statement seriously (I 57), his contemporary Vico clearly does.<sup>26</sup>

Still, Mandeville's pessimistic view was soon rejected by mainstream economics. I have already mentioned that Shaftesbury defends a very different anthropology according to which humans have both selfish and sociable instincts. This theory is further developed, in varying forms, by both David Hume and his friend Adam Smith, who was a professor of moral philosophy and first wrote *The Theory of Moral Sentiments* before he authored *The Wealth of Nations*. I shall look shortly at their criticism of Mandeville. In his essay *Of the Refinement in the Arts* (originally called *Of Luxury*) of 1752, David Hume addresses in a classical way the question that vexed many of the theorists of the eighteenth century – namely, whether the increasing wealth of modern societies is in itself good or bad. He begins by recognizing, similarly to Mandeville, that '*Luxury* is a word of uncertain signification'.<sup>27</sup> He then proceeds by declaring that the gratification of a sense

<sup>24</sup> Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nation*, ed. by C.J. Bullock, New York: P.F. Collier 1909, 20.

<sup>25</sup> David Hume, as an economist no less original than as a philosopher and a historian and the crucial intermediate figure between Mandeville and Smith, impressively demonstrates in *Of the Balance of Trade* how an equilibrium will be achieved much better without any state interventions. Paul A. Samuelson/William D. Nordhaus, *Economics*, New York: McGraw-Hill, 13th ed. 1989, 943 write: 'His argument is as important today as then for understanding how trade flows get balanced'.

<sup>26</sup> Giambattista Vico, *La scienza nuova*, Milano: Rizzoli, 1977, 176 f. (the seventh *degnità*).

<sup>27</sup> David Hume, *Essays Moral, Political, and Literary*, ed. by E.F. Miller, Indianapolis: Liberty Classics 1987, 268.

is not of itself a vice; furthermore, it has positive consequences: the desire for refined pleasures helps people to overcome indolence, which is never an agreeable state; progress in the mechanical arts stimulates the liberal arts; men become more sociable; brutal excesses are mitigated by refined pleasures; states become stronger; economic progress favours the formation of a middle class and thus political liberty. However, Hume recognizes that the gratification of a sense can become a vice if it occurs at the expense of some other virtue, such as liberality or charity. Hume adamantly rejects the position that only the vicious can achieve the good economic results that both he and Mandeville favor. Certainly, the desire for luxury may motivate people to work more, and their demand may then create jobs for the poor. But if a person liberates himself from this desire and still works the same amount, he may well spend his money 'in the education of his children, in the support of his friends, and in relieving the poor...that labour, which, at present, is employed only in producing a slender gratification to one man, would relieve the necessitous, and bestow satisfaction on hundreds' (279). A world in which all these positive consequences could be achieved without any vice is logically possible. Yet Hume agrees that, given other human vices such as sloth, the removal of the desire for luxury goods may have negative consequences. He insists on a holistic approach: 'You must only take care to remove all the vices. If you remove part, you may render the matter worse. ...Let us, therefore, rest contented with asserting, that two opposite vices in a state may be more advantageous than either of them alone; but let us never pronounce vice in itself advantageous' (279 f.). Hume then attacks an author, not mentioned by name (even if the footnote refers to *The Fable of the Bees*), for claiming that moral distinctions are only inventions of politicians, while at the same time averring that vice is advantageous to the public. For something of this nature could hardly be a vice. Mandeville might object to Hume that something, whose *unintended* consequence is good, may well be bad, but Hume might retort that the politician who, after reading Mandeville, Hume, or Smith, understands these consequences can no longer regard them as unintended. Mandeville might then answer that this does not yet prove that the politician's *motive* is to achieve these good consequences. In practice, however, Hume and Mandeville are not that far from each other, for Hume agrees that a humanity without vices is not a *political* possibility. Still, he insists on the *philosophical* relevance of his criticism.

Seven years after Hume, Smith addresses Mandeville in the last part of his *Theory of Moral Sentiments* and points to two main weaknesses of the

theory: he shows that 'self-love may frequently be a virtuous motive of action'<sup>28</sup> and that in any case the desire to render oneself the proper object of honor cannot be called 'vanity'; he furthermore rejects Mandeville's premise that any indulgence in any passion is vicious. Smith recognizes that out of this rigoristic position arose a system 'which, though perhaps it never gave occasion to more vice than what would have been without it, at least taught that vice, which arose from other causes, to appear with more effrontery, and to avow the corruption of its motives with a profligate audaciousness which had never been heard of before' (494). Smith is right that Mandeville's justification gave the human desire for profit, which the earlier tradition had regarded with suspicion, if not contempt, the possibility of expressing itself with an effrontery unheard before. Mandeville's cynicism, however, still rests on a rigorist ethics of Jansenist provenience. Even if he sees selfishness at the bottom of all things, he thinks it is in dire need of justification via its consequences. A much greater effrontery can be expected after such a background has evaporated and the search for virtue has been replaced by an increasingly individualistic concept of rights. Then the argument that the market is the best tool for achieving certain objectively good ends, such as a rational allocation of scarce commodities, yields to the idea that, independent of the results, the free choice of economic activities is the ultimate end to which everything else must be subservient.

## II.

Any ethical analysis of capitalism that does not recognize that this system uses, in a way unknown before, mechanisms not intended by, but still inherent in, human actions is hopelessly naïve. The moralist protest that is unfamiliar with these mechanisms rightly meets with scorn from the side of economists whose main purpose is to study them – a study that has become increasingly more demanding due to a mathematization that only partly mirrors the mathematical operations of economic actors: in part, it describes processes that occur, as do processes in nature, without their agents being aware of the mathematical logic that determines them. Still, economic theory does not simply mirror economic reality; it impacts it, since intelligent economic actors try to learn from it. This is one of the reasons why several successful economic policies cannot be used over the same

<sup>28</sup> Adam Smith, *The Theory of Moral Sentiments*, Indianapolis: Liberty, 1976, 488.

amount of time as engineering procedures but are, rather, far more short-lived. The economic agents may react against them and thus render them obsolete, since they describe a reality with agents not yet aware of them. The crisis of Keynesianism had to do with the fact that, after some decades, people developed rational (not simply adaptive) expectations and anticipated in their demand for higher wages the inflation that was part of the Keynesian solution; this, however, led to both unemployment and inflation.<sup>29</sup>

On the other hand, an intelligent moral criticism of economic behavior remains possible and necessary. Even if, in the course of the nineteenth century, the social sciences, including economics, detached themselves from ethics and became value-free,<sup>30</sup> every human action remains subject to a moral judgment. Clearly, the development and deliberate fostering of the triad of modern science, technology, and capitalism<sup>31</sup> with its incentives on investments has led to a historically unparalleled economic growth and to absolute wealth for a huge number of people (without necessarily diminishing relative poverty – which, however, is a far lesser moral problem). Furthermore, capitalism is not simply an economic system based on private property, market mechanisms, and the universalized desire to maximize profits by intelligent investments; capitalism is expression of a certain mindset. It not only creates wealth; it has changed the value system of society as profoundly as few other events in history. Some of these changes are morally noble: capitalism is based on a new appreciation of work and discipline and on the idea that people have to *deserve* their wealth by *earning* it.<sup>32</sup> It takes the human desire for freedom and for upward mobility very

<sup>29</sup> I refer to Thomas Sargent and Neil Wallace's famous policy ineffectiveness proposition.

<sup>30</sup> On this process, see Vittorio Hösle, 'Zur Philosophie der Geschichte der Sozialwissenschaften', reprinted in: Vittorio Hösle, *Die Philosophie und die Wissenschaften*, München: C.H. Beck, 1999, 125-165 and 230-233.

<sup>31</sup> Arnold Gehlen has called this the 'Superstruktur' of modernity (*Die Seele im technischen Zeitalter*, Hamburg: Rowohlt, 1957, 11 ff.).

<sup>32</sup> The following anecdote in Plutarch's *Life of Lycurgus* (24.3) manifests the opposite attitude of a traditional society: while at Athens, a Spartan heard of a citizen who had been fined for living an idle life and he was stunned that someone 'was condemned for living like a freeman. So much beneath them did they esteem the frivolous devotion of time and attention to the mechanical arts and to money-making' (Plutarch, *The Lives of the Noble Grecians and Romans*, translated by J. Dryden, revised by A.H. Clough, New York: Modern Library, s.d., 68). The attitude lasted much longer; think only of William Dorrit in Charles Dickens's *Little Dorrit*.

seriously but, at the same time, ties these desires to the necessity of work. In an ideal capitalist system – one in which the roles of luck and inheritance would be dramatically reduced – a person could become rich only by satisfying other persons' needs. Even though this new mobility may well lead to enormous disparities, the system is more egalitarian than earlier social forms and gives the consumer incomparably more power than does any planned economy, even one that is democratically legitimized, for in a market economy the consumer can contribute by her purchase, the equivalent of a vote, to determining what will be produced. By creating a global economy, capitalism furthermore creates an interdependence that makes going to war less rational (which is not sufficient to prevent it). Still, there are three decisive moral limits of capitalism.<sup>33</sup>

First, let us assume that there would indeed exist an absolute convergence of self-interest and public welfare. A decisive distinction in ethics is that between what is objectively right, a state of affairs that is desirable for moral reasons, and what is subjectively moral, the intention that aims at this state of affairs for the reason that it is objectively right. It is doubtless true that a subjectively moral intention must aim at what seems objectively right.<sup>34</sup> But it may not aim at what *is* objectively right, owing to ignorance, without forfeiting the claim to be subjectively moral, and certainly the inverse also holds: objectively right results may be brought about by persons who are not subjectively moral – i.e., not committed to a perspective that transcends their self-interest. The difference between the objectively right and the subjectively moral is thus ineludible. Now, the idea that lies at the basis of capitalism makes it more difficult to find out whether an action is subjectively moral; for its enormous success rests exactly in creating a system in which the pursuit of one's own interests leads to public benefits. Therefore, successful economic activities may be motivated as well by greed as by a sincere concern for the welfare of others. Since it is not moral to subject one's fellow human beings to groundless suspicions and since, without further information, both accounts are plausible, it is not permissible to say that the person who achieves economic success must be moti-

<sup>33</sup> Cf. Vittorio Hösle, 'Versuch einer ethischen Bewertung des Kapitalismus', reprinted in: Vittorio Hösle, *Praktische Philosophie in der modernen Welt*, München: C.H. Beck, 1992, 109-130 and 206-210.

<sup>34</sup> See Thomas Aquinas, *Summa theologiae*, I-II, q. 18, a. 2 and Vittorio Hösle, *Morals and Politics*, Notre Dame: University of Notre Dame Press, 2004, 95 ff.

vated only or primarily by selfish regards. Even less is it acceptable to criticize the political actors that allow the unfolding of capitalism, if they have good reasons to believe that this is the most efficient way of achieving universal wealth – at least as long as they themselves do not benefit from their own economic policies. Still, it is important that our curiosity regarding our ultimate motives be satisfied, and thus it is a blessing in disguise that this harmony exists only partially. For even if the market leads to an equilibrium between supply and demand, it satisfies only the needs of those that have purchasing power – and there are quite a few persons without it, not all of whom are responsible for their situation through their own decisions. While it is a reasonable moral decision not to encourage sloth, starving children cannot be reproached for their condition, and even adults who did not have access to an education that would have enabled them to acquire the capacities necessary in order to flourish in a complex market society are hardly responsible for it. Intelligent charitable activities are always possible, and they are important not only because they address problems that the market cannot solve but also because they uphold a behavior which is more likely to be an expression of the subjectively moral.<sup>35</sup> Even if Mandeville is right that some of this behavior may be motivated by vanity, it is a sophism to regard all human behavior as selfish only because it inevitably must be motivated by something within the subject herself. There are differences between our motives, and the willingness to achieve something good even if one does not profit from it is not the same thing as aiming solely at one's own interest. A world without generous charitable work would be poorer on the subjectively moral level, even if it could achieve the same, or a greater, degree of the objectively right. (In fact, such foundations constitute a third sector between the private and the public, which, due to competition, often works more efficiently than the public one, even if sharing its commitment to something that transcends the private interest). Those successful entrepreneurs who invest their profits in non-profit foundations dedicated to moral ends deserve more moral respect than those who don't.<sup>36</sup>

<sup>35</sup> I do not deny that charitable work, too, is subject to the economic imperative of rational allocation of scarce resources, but it differs from normal economic behavior by not being primarily motivated by self-interest.

<sup>36</sup> Andrew Carnegie's *The Gospel of Wealth* (New York: The Century, 1901) remains a classical example of this commitment. 'This, then, is held to be the duty of the man of wealth: to set an example of modest, unostentatious living, shunning display or extravagance; to provide moderately for the legitimate wants of those dependent upon him; and,

Second, let us move from the level of the subjectively moral to that of the objectively right. The person who becomes rich in a legal way in a market economy has the merit of having satisfied the needs of persons with purchasing power. This is, whatever its motive, something *prima facie* objectively good. I add 'prima facie' because the concrete value of this act depends strongly on the nature of the needs satisfied (and perhaps created) by the supplier. Certain needs are essential to our survival or our flourishing as moral and intellectual beings. But there are other needs whose satisfaction does not make us better or happier beings, and there are even needs whose fulfillment harms either us or other people. The success of modern economic theory consists in its capacity to develop a general concept of factual preference ordering that is able to explain prices, and no doubt this procedure is legitimate. Nevertheless, reducing values to the factual prices is unacceptable, tempting as it is on the basis of a radical empiricism, since prices are empirical facts, while the ontological status of values that are not reducible to factual preference orderings is more dubious.<sup>37</sup> Still, 'knowing the value of nothing and the price of everything'<sup>38</sup> is the mark of vulgarity. There are good moral reasons to value various needs differently, and thus also the economic activities that satisfy them. No doubt the moral entrepreneur, too, must survive on the market, and thus he must address needs that exist or can easily be elicited. But his moral dignity depends on him being able to find an intersection between what he regards as moral needs and what are merely factual needs. But not only are not all needs respectable; satisfying them may directly harm the buyer, even if he craves their satisfaction. Heroin addiction would be an obvious example, but there is a far larger gray zone: think of tobacco addiction. Even if one does not agree that harming oneself is morally permissible, there is little doubt that harming others is worse. But many economic activities rely on externalizing costs – that is, passing on damages

after doing so, to consider all surplus revenues which come to him simply as trust funds, which he is called upon to administer, and strictly bound as a matter of duty to administer in the manner which, in his judgment, is best calculated to produce the most beneficial results for the community' (15).

<sup>37</sup> Thus Thomas Hobbes writes: 'The *Value*, or *worth* of a man, is as of all other things, his Price; ...and therefore is not absolute; but a thing dependant on the need and judgment of another. ...And as in other things, so in men, not the seller, but the buyer determines the Price' (*Leviathan*, London/Harmondsworth: Penguin, 1987, 151 f.).

<sup>38</sup> Kenneth E. Boulding, 'The Basis of Value Judgements in Economics', in: *Human Values and Economic Policy*, ed. by S. Hook, New York: New York University Press, 1967, 55-72, 67.

to others. The ecological crisis is one of the results of such externalizing: we pass damages on to those who cannot defend themselves against said damages – either persons in less developed countries or future generations. Future generations are particularly weak, because they lack both purchasing power and suffrage; thus, they play hardly any role in the two main institutions of modernity, the market and democracy. Clearly, it is one of the main tasks of a just legal and economic policy to develop a set of rules that renders the externalization of costs more difficult, partly by redefining the contribution of nature to national wealth and raising accordingly the prices for natural resources, partly by extending liability, and partly by empowering future generations. It can hardly be expected from a moral entrepreneur that he renounces the externalization of costs when this would lead to his failure on the market due to the fact that his competitors would not join him. But he certainly may be expected to give up activities that would only increase his profits without being necessary for his survival. Particularly, he should lobby for, not against, those legal reforms that would render the externalization of costs more difficult.

But not only may capitalism sometimes be an expression of motives that are not subjectively moral; not only may it accelerate processes that are objectively wrong, such as the externalization of costs; the mindset of capitalism, utterly unleashed, may, thirdly, develop a tendency of being even self-destructive. Why? Capitalism's healthy mistrust against persons who want to benefit from the work of others without working themselves can lead to a general skepticism against charities and to the ideology that maximizing one's own profit is the main purpose and the sole duty of life. If this mindset spreads, capitalism itself is endangered. For as even Mandeville understands, capitalism can only unfold if the administration of justice is not for sale to the highest bidder. Something analogous holds also for the activities of the central bank and the economic policies of the government in general. For every incentive to work will disappear if the poor person in a litigation must fear that the judge will assign the produce of his work to the richer party, if the owner of a savings account has reason to believe that the central bank will accept an inflation that will deprive him of his modest savings while helping speculators, or if the dynamic entrepreneur with the superior product will be ignored by the minister who has been bribed by a less efficient competitor. Capitalism presupposes far more trust than pre-capitalist systems (after all, it lives from people entrusting their savings not to their stockings, but to banks), and the evaporation of social trust must, in the long run, corrode its capacity to function.

Of course most countries have laws against corruption, but if the judges who have to apply these laws are themselves corrupt or if a government succeeds in limiting the applicability of these laws, corruption will almost inevitably spread. Needless to say, this will poison not only the political but also the economic process. Still, this process may take one or more generations and, from the point of view of pure rational egoism, for some agents, particularly if they are elderly, it may well be recommendable to pursue such a strategy: There is no guaranteed harmony between rational interest and moral duty. Probably the persons who engage in corruption will calm their consciences by saying that they do nothing more than extend the basic principle of economic rationality to the political realm. While the number of countries in which such shameless corruption reigns is not too big, a less direct way of changing the laws is almost ubiquitous: lobbying in parliaments. No doubt, in a democracy economic actors must be able to propose reasonable changes to their legislators; but the changes proposed are not always in the public interest, and the strength of character necessary to reject them may well become rarer in a society that values profits more than anything else. If, furthermore, the opinion has become dominant that there are no objective criteria for just economic policies, one should not be too surprised if politicians engage in activities that are likely to enhance their own interest, be it directly economic or connected to their desire of maintaining – and perhaps expanding – their political power. Daniel Bell has spoken of the cultural contradictions of capitalism, mainly having in mind the contrast between the drive for optimization and economization on one hand and the modernist revolt that longs for pre-modern forms of expression on the other.<sup>39</sup> But the conflict between the unleashing of the desire for profit in order to promote growth and the necessity of maintaining a political class that understands itself as the guardian of the market independently of its own economic interest is even more dangerous. Probably the value system of early modern elites, inspired as it was by self-respect, desire for honor, an admiration for virtuous behavior, and religious awareness, was necessary to bring forth a functioning capitalism,<sup>40</sup> and it is not clear to me whether capitalism can keep going if these moral presuppositions are relinquished. If Mandeville the moral philosopher triumphs, Mandeville the economist's defense of capitalism will collapse.

<sup>39</sup> Danil Bell, *The Cultural Contradictions of Capitalism*, New York: Basic Books, 1976, 84.

<sup>40</sup> I cannot discuss here the old Weberian question how important Protestant ethics was for the rise of capitalism. The contribution of the Jesuits was considerable, too – but, in any case, both groups offered religious justifications before Mandeville could propose his secular solution.

COMMENTARY ON THE PAPERS  
PERSONAL & FAMILY DECISIONS  
IN A SCENARIO OF UNCERTAINTY  
&  
ETHICS AND ECONOMICS:  
NEW CONSIDERATIONS FOR ENTREPRENEURS

MINA RAMIREZ

INTRODUCTION

I thank Prof. Msgr. Minnerath for a very lucid paper that elaborates on why the ‘practices of economic development’ which have caused the global economic downturn have been antithetical to the principles of Christian Social Doctrine – human dignity, integrity of creation, common good, social justice, subsidiarity and solidarity. Indeed, the current dominant global economic system centered on big enterprises and international financial intermediaries has unwittingly considered the person merely in ‘economistic’ terms as a commodity or a factor of production that entails cost.

The mentality, the worldview of the dominant economic system has created the condition which led to the global economic crisis. Prof. Vittorio Hösle traced back – since almost 500 years ago to the present – the philosophical orientation that has fostered an absolutely individualistic mentality thus shaping a worldview which culminated in the present neo-liberalistic mentality. Cited by Prof. Hösle were the three ‘radical moral innovators’ of the social question: Niccolò Machiavelli (1469-1527), extreme individualism in the realm of politics, Bernard de Mandeville (1670-1733), absolute individualism in the field of economics, and Robert Malthus (1766-1834) in the area of demography.

An understanding of Adam Smith’s view of the economy taken out of context – ‘that the economy is partly a self-regulating system’ (‘It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our

dinner, but from their regard to their own interest') 'and that therefore appeal to goodness was not necessary' (cf. Hösle's paper) – has reinforced the extremely individualistic tendency in the practice of economics and has led to the neo-liberalistic capitalism which is characterized by a worldview that is materialistic, mechanical, egoistic and consumerist. Egoism considered by corporations as the essential stimulus for a vibrant economy has led to making the business enterprise or organization in any institutional sphere (run like a business) the central place in life and proclaimed this as the salvation of people and the fulfillment of their sense of happiness and well-being.

While there is no doubt that peoples in the developed and the developing world, especially the base groups, have been extremely affected by the global economic downturn, the resolution of the manifest effects of it – namely, monetary poverty, violence, discrimination, and degradation of the environment – has been complicated by a weak state and weak institutions which are directly or indirectly the effects of 'colonization' both from foreign and local powers.

Taking the Philippines as a case in point, I am presenting a program of action and advocacy – based on an analysis of a complex economic problem by socially enlightened businessmen and reflections from the analysis of political thinkers and moral theologians – intended to awaken base groups to a paradigm of development on a mezzo level that will lead to community economics and premised on the person who is not just a 'homo economicus' but one who is called to fulfill a mission in life to contribute to the well-being of family and community through the flowering of his/her inner gifts of body, mind and spirit.

#### THE SITUATION OF UNCERTAINTY

The present expression of this individualistic tendency in the economy and in politics is now known as neo-liberalism. Yes, the economic global crisis has happened within this context of a Neo-Liberalistic climate. The present global crisis has been branded by Joseph Stiglitz as a crisis that was 'made in USA'. The absolute belief in Adam Smith's 'invisible hand' has shaped the general economic policy in U.S. especially in recent years. The principle derived from this conviction is that the state should not interfere in the law of the market for to interfere in it will prevent the workings of the invisible hand supposedly to create a social order (and even a world

order) which will redound to the social equilibrium in society. Neo-liberalism has created the big enterprises considered to be the salvation of people's desire for happiness. The logic of this system is the following: Enterprises expand employment possibilities. Employment puts more money in the hands of the employees. Through more income, the employees should be able to buy goods and services – food, education, health, communication, etc. Thus, enterprises should expand to create more employment. More income through employment creates more demand for goods and services, more production and hopefully more savings, more taxes for basic services and physical infrastructures, more investments and so is the cycle of economic life. First class entrepreneurs are effective in expanding more employment opportunities. They are also highly competent, highly capable and efficient, producing goods with the least cost. In this line of thinking, more often than not, the person of the employee is considered merely as a cost of production. The ethics underlying management decisions as laid out by Christian Social Teachings affecting labor is seldom considered.

The logic of business enterprise no doubt has created comfort and amenities in life. It has brought about the rise in GDP or GNP as the measure of the wealth of the nation. The downside, however, lies in that the failure of markets to regulate itself is bound to create inequality. Moreover, it also has exploited the use of natural resources and natural habitats. Thus, maximization of profits in enterprises and entrepreneurship has made the rich and the powerful richer and the poor poorer within countries and among countries. It is this neo-liberalistic economic and political ideology that has caused the global economic downturn.

The foregoing situation has unconsciously developed a worldview of materialism, egoism, mechanical and consumer-oriented systems – now entrenched not only in economic institutions but also in institutions of education, health, and communication and information technology (especially pronounced in mass media). In this system the families especially of base groups in the rural and urban areas are trapped. They suffer from poverty, rampant spates of violence, and destruction of 'commons' due to degradation of the environment, the result of industrialization and commercialization. An alternative worldview is demanded, a worldview that is spiritual, rooted in the life-values of popular cultures, trans-egoic, i.e., community-oriented, organic, ecological. It is a worldview that will elicit what is deeply embedded in the heart of every person – the aspiration for a decent life for each and every man, woman, and child without exclusion and marginalization. There has been enough empirical evidence that merely money or

material possessions will not bring a sense of well-being and happiness. Happiness is not just associated with money. Indeed the global economics (which recently had its downturn) has been dominated by big business and international financial intermediaries. This economic paradigm has been supported by national governments, first rate entrepreneurs and communication and information technology – by and large, the cultural supports of the neo-liberalistic economy and of the advocacy for free markets without state regulation. It has produced *the scenario of uncertainty* experienced by persons, families and communities within countries and among countries with its multifaceted divides – cultural, economic, socio-political, intergenerational, rural-urban, digital and our divide from Mother Earth. How will persons and families cope with this scenario of uncertainty? Given the present global reality of gigantic enterprises and full-blown financial trade that have been operated by highly efficient entrepreneurs, but have created inequalities, divides and ‘disconnects’ – there has been a search, albeit by a powerful minority, for reclaiming the ethics derived from natural law, embedded in the human heart, and the explicit articulation of the implicit natural design of creation for the flourishing of life.

#### THE NATURE OF UNCERTAINTY

My commentary is based on my reflective analysis experiences in the Philippines (‘the state that developed after the declaration of Philippine independence in 1946’). Yet this analysis may apply to other politically colonized countries particularly in many countries of Asia and in Africa.

There has already been a situation of uncertainty since the liberation of the Philippines from political colonial rule. It has been known to be the first democratic country in Asia and one whose people, especially those of the lowlands, have been quick to embrace Christianity. After the war, it was known to be second to Japan in terms of economic development but now has been lagging behind its Southeast Asian neighbors.

The scenario of uncertainty in the Philippines, is not only just a result of the present global economic downturn, but also due to a weak state of nationhood.

Quoting from Banloi, Rommel:

*The Philippine state is in the predicament of having to face globalization while at the same time undergoing the painful process of nation-building in a highly diverse society. The weakness of the Philippine*

*state in facing these challenges is causing the pervasive poverty that result in ethnic, socio-economic and religious tension. To overcome these challenges, there is a need to strengthen the Philippine state and institutions of governance.*

A weak state of nationhood also means weak institutions that fail to serve the good of families and communities. Even prior to the period of talks on Globalization, I have been describing the Philippines as having a culture of insecurity caused by the great gap between the rich and the poor. Without being prepared for it, the Philippines bravely accepted the challenges of globalization since it acceded to the World Trade Organization (WTO) in 1995. This unpreparedness for global competition has in fact aggravated the culture of insecurity and sense of uncertainty of the great majority of the Filipino people and their families. Undiscerning national and global leaders did not foresee the implications of the neo-liberalistic policy which tends to subordinate all institutions to the interests of big business with government guaranteeing economic salvation through monopolization of power and wealth in transnational corporations and transnational financial intermediaries. And because those who re-enforce this new colonialism are also some prominent national powerful and wealthy leaders, the ideology is unintentionally propagated in educational institutions and other institutions as well. Through this dominant educational process supported by a fast growing communication and information technology, the gap between the rich and the poor widens. It has led to the deterioration of the quality of life due to a severe structural imbalance that creates and re-creates the cycle of monetary poverty especially among base groups of fisher-folk, farmers, indigenous groups and informal urban dwellers. A new form of colonization which I define as 'violence of the mind and heart' both from foreign and local entities thrives (cf. Appendix I on how to integrate popular cultural system and the dominant cultural system).

His Holiness, Pope Benedict XVI, has captured the effects of colonization in *Caritas in Veritate* (no. 33) and I quote:

*More than forty years after Populorum Progressio, its basic theme, namely progress, remains an open question, made all the more acute and urgent by the current economic and global crisis. If some areas of the globe, with a history of poverty have experienced remarkable changes in terms of their economic growth and their share in world production, other zones are still living in a situation of deprivation, comparable to the one which existed at the time of Paul VI, and in some cases one can even speak of deterioration. It is significant that*

*some of the causes of this situation were identified in Populorum Progressio, such as the high tariffs imposed by economically developed countries, which still make it difficult for the products of poor countries to give it foothold in the markets of rich countries. Other causes, however, mentioned only in passing in the Encyclical have since emerged in greater clarity.* A case in point would be the evaluation of the process of decolonization, then at its height. Paul VI hoped to see the journey towards autonomy unfold freely and in peace. More than forty years later, we must acknowledge how difficult this journey has been, both because of new forms of colonialism and continued dependence in old and new foreign powers, and because of grave irresponsibility within the very countries that have achieved independence. (underscoring, mine)

Leonard Boff, author of books on liberation theology, has written another book titled, *Cry of the Earth, Cry of the Poor* (Orbis Books, 1997). His thesis in this book is that the logic that has deprived people of their human rights to live a decent life is the same logic that has caused the degradation of the environment and our planet earth. This has been the logic that has also produced the economic downturn that is now evermore aggravating the problem of persons and families especially in the so-called developing and underdeveloped societies. The logic of the present mode of industrialization and commercialization may have worked for a time but we know that this has benefited only the more powerful and wealthy in various societies. Enterprises may have created a lot of employment but also underemployment or worse unemployment. To resolve the economic downturn with the same logic may just recycle the situation of poverty and the widening gap between the rich and the poor.

#### SOME EFFECTS OF GLOBALIZATION

Clarence Henderson has identified the following as effects of globalization, 'accelerating globalization of international finance and trade', 'information in real time', 'large ethnic and international migration', 'a world widespread of criminal syndicates', 'homogenization of cultures', changing 'consumer expectations, preferences, and lifestyles in an irrevocable fashion', 'dominance of...mass media culture and the extermination of local cultural values and arts'.

In the Philippines, the advent of globalization has even more complicated nation-building in the context of the many islands, languages, poor ethnic minorities with differentiated religions, unbalanced social classes, and prevailing poverty.

#### PERSONS AND FAMILIES IN A TIME OF UNCERTAINTY: PRACTICE AND RECOMMENDATION

No family adversely affected by the global economic crisis can resolve by itself its misery and state of deprivation.

In my country poor families have been assisted by thousands of worthy initiatives from among non-governmental institutions or through the initiatives of civil society. Schools, Colleges and Universities have their outreach programs. Churches of different religious persuasions have their charitable and/or social action programs. Options for the poor through Basic Christian Communities (BCCs) or Basic Ecclesial Communities (BECs) as a way of being Church has been the thrust of many churches in Asia. Non-governmental organizations are involved with sectors: with focus on children, youth, indigenous groups, women, families, sectoral groups such as farmers and fisher-folk and workers' unions; and/or committed to family life and responsible parenthood, causes such as sustainable agriculture, housing, health and nutrition, para-legal services, creative arts, disaster preparedness, community communications, formation of cooperatives, micro-finance or micro-credit, environment and action on climate change. Indeed all these social initiatives of Civil Society have been the redeeming factor of people's sufferings while on the whole, people have been cynical whether or not so-called democratic elections would bring changes to poverty situations. That in the Philippines there are 4 million overseas workers in about 190 countries of the world is telling us that the income levels of the great majority in the country are not adequate for them to live a decent life.

In a country where a culture of insecurity is experienced since after World War II due to unbalanced social structure, the movement of organizing people to fight for their basic rights or to enhance community development has been ongoing. In 1967, the year when *Populorum Progressio* was issued, a Rural Congress was organized by the Catholic Bishops of the Philippines (CBCP) with collaboration from three academic institutions, pertinent NGOs and government agencies to discuss the problem of the

rural poor. The emphasis then was that the Church worked with government and NGOs to bring about a better quality of life for the people. In the first Rural Congress, the participants were mostly from Academia, Government and some Rural Organizations. Forty years later in 2007, the 2nd Rural Congress was again organized by the Church. This time, the participants were mostly leaders of organized groups of farmers, fisher-folk, indigenous groups, industrial workers, women and youth and small traders. Indeed, forty years have shown that community organization and community development must have sustained the people despite an experience of lack of good governance. The process of nation-wide consultation with the marginalized sectors, ended with 73 bishops listening to 'cries of the poor' in a two-day-workshop, July 7-8, 2008. Most Rev. Pablo David, DD, a noted theologian in the Philippines, emphasized the implications of having listened to the plight of the poor. He alluded to the Gospel story of the Good Samaritan who (unlike the Levite and the Priest 'well meaning persons' hurrying about their daily task of serving the Temple) was able to come close to the ill-stricken person, was touched with compassion, took care of the victim, brought him to an inn and requested the innkeeper to take care of him at his expense. Bishops and priests and professionals have listened to the 'cries' of the poor during the culmination of the Rural Congress. This 'seeing' up close, according to Bb. Pablo David, demands from the Church – particularly, bishops, priests, and professionals – a serious social responsibility.

Families of marginalized sectors need to organize themselves but, beyond such organizations, should be the spirit of respect for the diversity of inner-giftedness of each person and the desire for authentic solidarity and communion (cf. *Caritas in Veritate*, Chapter V, the Cooperation of the Human Family, nos. 53-55).

I must say there is, in the Philippines, a vibrant Civil Society that tries to resolve the problem of a weak state. And yet, everybody in the Philippines would agree that all these initiatives offer at best some comfort to the sufferings of the people who demonstrate resiliency in the face of overwhelming problems. It will take perhaps two generations more to bring about a social transformative impact on national leadership. For as long as there is a weak state allegedly riddled by corrupt practices, there will be no sense of progress no matter whether or not the leadership speaks of a high economic growth rate that is due, not to addition of real value, but to the contributions of about 4 million overseas workers sending their remittances to their respective families, an indication of an economy that is not

functioning for the great majority of the people. Although the people's ideals are held high and legislature churns good bills, sound legislation is still not being implemented. Thus the cycle of poverty and the degradation of the environment, caused by big business, continue, maintaining the great gap between the rich and the poor, preventing any real transformation from happening. At best all the small initiatives fail to transform the system because those in command are too powerful to listen to the 'cries' of the poor.

#### A RENEWED PARADIGM OF DEVELOPMENT

A new paradigm of development and a new economics on the mezzo level is needed to aid persons and families to start working for their authentic wealth, well-being and welfare. I propose here a discourse among colleges and universities pertinent to colonized societies to address the problem of weak states and inadequate institutions, focusing on a development paradigm aimed firstly at developing a sub-cultural area – a development on the mezzo level. This sub-cultural area should be around a watershed district. It is the watershed that connects forests, land and sea. Thus, we call this watershed area a bio-regional community. It is the watershed that creates its specific economy and has developed the natural habitats of people. It is where the outreach or extension programs of the university could identify partners among non-governmental organizations and people's organizations in the bio-regional community (which may span two to three municipalities). The first step to take for this program that introduces a new paradigm of development is a series of consultations from among the leaders of base groups of fisher-folk, farmers and indigenous groups to bring awareness of their connectedness with reference to the preservation and protection of their environment and also to guarantee food security in the area. It is where they may make decisions to exchange basic food items, not exporting them to other communities as long as the community needs them. The series of consultations may also bring the base groups to recover organic diversified farming systems basically for their needs and mutual benefit in the bio-regional community. There could also be consultations of organized leaders from the base groups with their local government, and leaders of institutions in the area, specifically in health, education, and educational institutions as well as church and, if possible, some enlightened business people in order for leaders representing organized grassroots

groups to question the local planning bodies and government agencies about government budgets supposedly to support their basic needs. This is where people could give their opinions as to how they will participate in implementing some good ordinances of the government pertaining to children's rights, family rights, and environmental rights. It is in these consultation sessions that even basic ecclesial communities of the church could discuss how Gospel values could help out in the promotion of responsible local political leadership. Children and youth representing various sectors in the community are given basic environmental practical education where, through love of their environment, they begin valuing and appreciating the wonders of creation, interconnectedness of forests, land and sea for life as well as protecting and preserving the balance of all elements of life – air, water, earth and light. Made aware of pollution in these areas, they are taught the meaning of how to reduce waste, re-use non-degradable waste and recycle it for value-added products. Entrepreneurship is developed in this process of trying to create community economics through various forms of cooperatives, some of them rooted in their indigenous forms of communal and cooperative ways of living.

What I am proposing is not just coming from an idea that has not been tried. It is at the moment the advocacy of the Social Science Graduate School of Transformative Praxis, the Asian Social Institute, which I have been heading since its Founder, a Dutch missionary priest, passed away in 1973. Despite its humble beginnings, the Asian Social Institute (ASI) with which I have been associated, first as a student and now its president, has become a specialized social science graduate school with a difference in that it has a strong social involvement from the perspective of Christian Social Teachings. It has combined scholarship and social action, with the marginalized as its frame of reference. It has integrated its three departments – Academe-Research, Social Development and Administrative Services– to pilot, on a long-term basis (since January 2007), the transformative education of a bio-regional community towards a new paradigm of development. Since the institute has been established to bridge the gap between the rich and the poor, in its 48 years of existence it is becoming not just a school but a movement of transformative ideas (based on experiences to facilitate the self-empowerment of marginalized sectors), a movement of inquiry and participatory action research, and a movement of advocacy and action... accompanying sectors and marginalized communities in reflecting on their journey towards the improvement of their quality of life according to their definitions.

The name we have given to our paradigm of development on the mezo level is 'Co-creating Sustainable Bio-Regional Community' (CSBcom). This program is operating in a pilot area in three municipalities of one province around a watershed district. In these programs we have partnered with NGOs, primarily the CFCA (Christian Foundation for Children and the Aging, supported by Kansas Diocese in US, which presently has 7500 member families in the province of Rizal, Manila), and organizations of fisherfolk that ASI formed and trained in the years 1979 to 1992. Presently, there is a core group of adult leaders meeting regularly to plan out their moves on their respective programs. There is 'Children and Youth in Action for a Sustainable Future' (CYASF), composed of various sectors of youth including youth leaders of village government councils. They have been formed and trained in environmental education, with each youth leader tasked to re-echo any training to his/her respective 'barangay' (lowest form of government unit). There are organizations of fathers of families, and organizations of women. All these organizations are accompanied by full-time paid professionals of ASI's Social Development, whose staff is composed of graduates of ASI's doctoral program (Applied Cosmic Anthropology), Masteral and BS Programs as well as the two-month IDCCD (International Diploma Course in Community Development). The staff serves as a catalyst to form people towards the Christian values of human dignity, integrity of creation, respect for differentiation, common good, solidarity and communion. Another significant program of ASI is accompanying a poor diocese in nurturing a Basic Ecclesiastical Community Culture which, after twelve years of accompaniment, now has 3600 family clusters in 28 parishes of the diocese and penetrates practically all villages. Transforming popular religiosity into a Living Faith Life, the basic ecclesiastical communities have shown how they resolve issues of daily family and community life. In solidarity with one another, after a strong typhoon, they came up with the rehabilitation of their homes and a coconut rehabilitation assisted by two agencies from Caritas, Philippines and Australian-Aid respectively. In both of these communities students and professors are exposed to the idea that the community should be part of the school and the school a part of the community. Since among the students of ASI are Asian foreigners representing 17 countries, this paradigm of development is a regular topic of discussion and sharing in the course offered to all students on 'Philosophy of Commitment to Total Human Development' (PCTHD), so that the practice of total human and social development with its value-underpinnings becomes an integral part of the worldview of the student – to live a lifestyle that is root-

ed in spirituality, and in the life values of a culture and nature's bounty. As experienced, Co-Creating Sustainable Bio-Regional Community has been an operating framework for three departments of the Graduate School – the Academe-Research, Social Development and Administrative Services – where all social concerns (children's rights, youth development, gender equality, community economics within which the ethics of small entrepreneurship is lived, environmental preservation and protection, use of technology with a soul, and citizenship with reference first to the bio-regional community) of the Graduate School and its partner communities find their place. It is where the values of *Caritas in Veritate* – respect for human dignity and integrity of creation, solidarity and subsidiarity, common good, gift and gratuity in economics are practiced.

This sense of gratuity was experienced by ASI administrators, staff and students after the floods caused by strong typhoons which destroyed homes and means of livelihood in October 2009.

The Asian Social Institute (ASI), with its meager resources, embarked on relief work with personal contributions from the ASI community (administrators, faculty, personnel and the students). This initial venture attracted other donors locally and abroad to make their contribution. An ASI graduate of the IDCCD course who works as a program director of a Japanese-based international NGO, volunteered to seek help from another NGO in Japan, the Japanese Platform. This organization has helped first in giving relief and in the rehabilitation of damaged houses and loss of means of livelihood. It is amazing that while the intended beneficiaries of the amount donated were 250 families, the families who were given funds for their housing needs shared part of the donated amount with their neighbors. Thus the 250 family beneficiaries increased to 369 family beneficiaries. This is the same with the packages given to them as relief. Some families could not accept that they were the only ones given them when some of their neighbors had not received them. They decided as a group to share what was donated to them with others. The family beneficiaries are now organized into CSBCom cooperatives so that whatever voluntary contribution is offered by the members will compose a common fund. The fund will be for preparedness for the next calamity that could occur in the future. It is this sense of natural community living that inspires ASI's graduate students to nurture a community spirit also in the institute-ASI, as ASI's partner community becomes a school of wisdom for professionals of varied disciplines.

Currently, there are two researches being undertaken in the community. One is an inquiry into developing Community Economics in the area

(See Appendix II for the specific research questions and questions for drawing out the implications of findings to 'Community Economics'). This research is sponsored by the Commission on Higher Education (CHED) in the Philippines. The research is being undertaken by researchers of two higher educational institutions of a state university and an all-women university, with the Asian Social Institute (ASI) as the lead role. The other study is a replication of the participatory research CYASF has undertaken called Photo Voice. With the assistance of the Kwansai University of Japan, which provided cameras to the youth, the youth were facilitated into a reflection of their dreams for themselves and for their community. After technical training in taking photos, the youth were asked to shoot pictures of whatever they would find significant. Hundreds of photos were taken... and it was a big task for the young people to first choose the quality photos, and then arrange the photos according to themes. There were five themes that came out from the youth's reflection – the beauty of their environment, evidence of environmental degradation, people's religiosity, daily life scenes in the community, and the situation of poverty. The photos, each with its caption, were exhibited for the community to view. These themes have become the basis of the three-year program of Children and Youth in Action for a Sustainable Future (CYASF). Austrian youth gave some financial support to the program. Austrian youth also immersed themselves in these areas. The Photo Voice research will be repeated, this time having as subjects out-of-school youth. The title of the research is 'Patterns of Youth Adjustment in Different Urban Settings'. In this study, ASI takes the lead role with professors from two other universities – Adamson University and Lyceum University – collaborating.

In the Philippines there are 200 universities and about 3000 colleges and 240 watershed communities. ASI advocates that: each university will take care of the development of a bio-regional community, especially because a university is rich in human resources. A university has students in engineering, architecture, medical sciences, education, psychology, social work, sociology, economics, management of business administration and fine arts. If all the students of these sciences get connected and immerse themselves in the lives of the people to gain wisdom from their experiences, while at the same time giving information on the factors that affect their lives, then I suppose we in developing countries will be able to contribute to a world of globalization characterized by subsidiarity and solidarity. International institutions may wish to help in this challenging process of a pro-people oriented development paradigm. The biggest chal-

lence of this undertaking is the continuous capability-building and formation programs of community partners and institutional leaders to facilitate and/or support the self-empowerment of the materially poor and, together with them, radiate the ecological, organic, trans-egoic and spiritual worldview as a source of ethics to influence the decisions especially of business and government policy-makers and executives.

ASI is divided into committees that will develop different dimensions of the CSBCom program: 1) Bio-regional organizing and networking; 2) Education and Trainin; 3) Support for Sustainable Communities and Projects; 4) Instructional Development; 5) Research, Documentation and Publication; 6) Promotions and Advocacy; and 7) Program Management.

In brief, the concept of this paradigm of development should operate first on the mezzo level. This concept was inspired by an economist, Dr. Sixto Roxas, who admitted he has had several 're-incarnations' for he worked first as a labor leader, then became a founding member of the Asian Institute of Management in Manila, was once a banker, adviser to multi-national corporations and became the main economic adviser of the former President Diosdado Macapagal (father of the present Philippine President). But now he firmly believes that the enterprise should not be the only hope of building wealth, health and well-being for the people but it should be the bio-regional community around a watershed area. Dr. Sixto Roxas calls this, 'Eco-System Based Community Centered Sustainable Organization and Management' This concept was reinterpreted by the Asian Social Institute (ASI) that called it instead, 'Co-Creating Sustainable Bio-Regional Community (CSBCom)'. As I describe it, ECSOM or CSBCom:

*ECSOM or CSBCom offers a new holistic development paradigm that revolves around the concept of Eco-Systems based Community-Centered Sustainable Organization and Management. Applied in a 'Watershed District', family clusters encompassing a few municipalities will make a social accounting of their community wealth.*

*All stakeholders of the bio-regional community – upland and lowland farmers, fisher-folk, indigenous groups, business, education, health, church and socially enlightened local officials – will engage in a long-term integral development process that is culturally-rooted, contextual, experiential and participatory. In and through a living Faith, it is hoped that the energy that will radiate from the process will cause the evolvment and organic growth of a community-based economics (not just enterprise-based), and a new urbanism that will prevent natural and human resources from being depleted. It is hoped that the*

*human habitat or the new human settlement will be an externalization of a vision of the City of God where all human beings may live a decent dignified life in harmony with nature. In this process, experts in financial management, engineers, lawyers, religious educators who, in dialogue with the people, especially the marginalized, could bring their expertise in service of improving the quality of life and well-being of communities. Thus, educational institutions (universities, schools and colleges as well as churches) could fulfill a significant role by which all activities pulsate with the divine energy from the heart of God alive in all creation.*

The new paradigm of development is an uphill climb. It is a shift from a mechanical, egoistic, materialistic and consumerist worldview to an organic, trans-egoic, spiritual and ecological worldview. It is actually awakening people to a new consciousness of the interconnectedness of life and all life-forms and making them realize the significance of creating networks of universities and colleges, churches and various religious persuasions, of non-governmental institutions and people's organizations. Beyond projects and programs should be a transformation to a change of a sustainable lifestyle rooted in one's sense of Godliness and/or spirituality, and in the richness of life-values of the culture and nature's bounty. What actually converts people to this new paradigm of development is the articulation of this concept by community partners themselves who can explain this in their own language and with their own symbols.

Making CSBCom operational is an attempt to embody the building of a 'civilization of love' an 'economy of trust', a culture of life, and a 'politics' of organized compassionate care. The philosophy underlying this process is the philosophy of part and whole, a philosophy of relationality, of inter-relatedness and interconnectivity.

To make whole is to make holy and to consider every human being and all creation as sacred, thus to be respected, preserved and cared for towards sustainability of the life-cycle in all its mystery and splendor.

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## APPENDIX I

### THEORIZING FROM EXPERIENCE

#### A PEDAGOGICAL AND RESEARCH APPROACH FOR SOCIAL TRANSFORMATION

MINA M. RAMIREZ

*Abstract of the inaugural lecture in the SoPHIA lecture forums organized by the Asian Social Institute to mark its 40th anniversary, March 12, 2003.*

Why theorize from experience? Reflected experience is a source of wisdom – a way to live and to enable people to be transformed to fully live a dignified life. A major question being addressed by the lecture was the why of rampant monetary poverty, voiceless citizens in a democracy, and gross violation of anti-graft laws, despite five hundred graduate schools in the country, two hundred universities, not to speak of an estimated 65,000 non-governmental organizations that form part of Civil Society.

I once accompanied seminarians of Maryhill School of Theology on a visit to the sacred Banahaw Mountain. In a dialogue with the Supreme Priestess of an indigenous religious group, she was asked whether or not they still hear ‘the holy voices in the mountain’ as they claim happen occasionally. ‘Not so much, anymore’, answered the Supreme Priestess. ‘The mountain is noisy, there are many strangers’.

The above story may be deemed *a metaphor* of what has happened to us Filipinos. Through the past four hundred twenty-five years, we have been listening more to foreign voices and less to the voices within us. In our personal and institutional life, we have had lessons from the experience of foreigners and strangers due to our long colonial history but have neglected to listen to the enlightenment we could gain from our own history, from our own story.

Due to our long colonial status, we have two cultural systems, two main cultural heritages working within us, albeit subconsciously. On the one hand, there is the dominant cultural system, which can be described as universalistic but impersonalistic, enhanced by the discipline of a monetized economy, formalized institutional life, and communication technology. This comes to us through the vehicle of Western languages, first in Spanish and then English. In schools we have been taught to ‘obey the law and you take care of the common good’. On the other hand, there is the ‘popular cultural system’ which gives us a worldview that is small group-oriented, and personalistic based on face-to-face communication. This is culture consti-

tuted by reciprocities and natural exchanges without the meditation of written law, money, or a sophisticated technology. The lack of integration between the Dominant Cultural System and the Popular Cultural System has produced the Erap phenomenon (the elected president who has capitalized on his image of not being articulate in English and so is one with the poor, later was impeached because of his style of governance that was a mirror of his personalistic way of governance with which the great majority of the poor could identify), the split-level Christianity of Rev. Fr. Jaime Bulatao, S.J., the underground economy, the settlement of conflicts outside of courts, the fact that in addition to traffic lights, policemen are still needed to enforce the traffic rules.

Integrating the two cultures calls for a two-fold imperative: 1) being aware of the underlying universalistic values behind the norms of the dominant cultural system and 2) heightening our consciousness of the underlying assumptions and life-values of our indigenous cultural heritage in which we should take pride. We should not become the victims of our colonial history – this is a given; on the contrary we should make this an asset especially now in a time of globalization. But we should take pride in our roots and through our values like *buhay* (life), *pananalig sa Diyos* (trust in God), *loob* (interiority) and *kapwa* (which according to the late expert of Filipino psychology, Virgilio Enriquez means ‘the other is also me’), *Pagdiriwia* (celebration), *pandama* (integrating sensing), etc. These life-values will give soul to the normative practice of the dominant cultural system.

To bridge the gap between the dominant cultural system and the popular cultural system, I address myself to the schools 1) for a culturally rooted education using qualitative (through the use of phenomenological and socio-linguistic methods) approaches in research, 2) for maintaining a bilingual system as long as the assumptions of each language and cultural system are clearly understood. To all education providers, I advocate a positive mapping of the Philippines, giving recognition to social initiatives and innovative ways of institutional leaders who demonstrate the integration of the two cultural systems towards a culture of life, responsible freedom, justice, peace and integrity of creation.

Source: *Philippine Star*, March 12, 2003.

## APPENDIX II

Research in Community Economics undertaken in the Pilot Area to develop a Sustainable Bio-Regional Community around a sub-watershed area in order to realize 'A New Development Paradigm' that is Gross Well-Being Oriented (GWB) and not just GDP or GNP oriented, by a group of Graduate Education Professors of the Asian Social Institute (ASI), Philippine Women's University (PWU) and the state university – Polytechnic University of the Philippines (PUP) with ASI having the lead role.

### QUESTIONS OF THE RESEARCH PROCESS.

*A. Based on the integrated Focus Group Discussion and Interview of Key Informants, let us examine the following:*

1. What are the economic activities in the locality and how are they related and connected?
2. To what extent do local economic activities benefit the people/community?
3. In what ways and to what extent are local human and natural resources optimally harnessed in order to develop the local economy?
4. What aspects of the local situation do the people/community want changed to strengthen their local economy and make them more responsive to the well-being of the community?
5. What can we conclude from the existing local economy, are the people being benefited from it?

### *B. Questions to Answer for Conclusions and Recommendations*

1. What is the nature of demand in the local economy (pick up point expenditures: how do they spend their earnings)?
2. Is this demand adequately met from within the local economy? Or is there a big proportion of supplying the demand from outside? What are the implications of this demand-supply situation to the development of the local economy?
3. How strong are the linkages of local economic activities and what are its implications to the development of the local economy? How can these linkages be improved to develop the local economy and contribute to the well-being of people?

4. How are human and natural resources optimally harnessed for the development of the local economy? For the attainment of the well-being of the people in the community?

5. Trying to answer the foregoing questions will enable one to make a statement of how marginalized are the potential members of the labor force and how exploited and abused are the natural resources in the local economy. It will also lead one to make recommendation for integrating human and natural resources deployment that will benefit the community without marginalization or exploitation.

6. From the above findings how will we now define community economics? Sustainable economics? Will these be the same as the definitions we had at the start of the research?

7. What are the general recommendations for: how to develop local economies in the Philippines? And in other developing countries?

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## PANEL ON THE PRODUCTION SECTOR

# THE PRODUCTION SECTOR

PETER HARRY CARSTENSEN

## 1. IMMENSE CHALLENGES TO THE WORLD COMMUNITY

Excellencies, Ladies and Gentlemen,

It is a great pleasure and honour for me to speak to you at the Pontifical Academy of Social Sciences. His Holiness Pope Benedict XVI has expressed it clearly: 'We must recognize our duty to hand the earth on to future generations in such a condition that they can live on it worthily'.

In his encyclical letter *Caritas in Veritate* he writes: 'On this earth there is room for everyone: here the entire human family must find the resources to live with dignity, through the help of nature itself – God's gift to his children – and through hard work and creativity'.

I fully agree with the Pope. It must go without saying that we handle the existing resources sustainably and with the greatest possible efficiency. Pope Benedict says that a just society can only be achieved through a change of heart. I say: that can be done. We are in the process of learning to satisfy our hunger for energy without destroying the finite raw materials.

We are about to experience a change in energy policy. That opens up opportunities. But it also involves conflicts of objectives. The global community must face the issues of the future: how are we to react to climate change? How are we to ensure a reliable energy supply? And how, at the same time, are we to feed the world's population?

These are the immense challenges the global community faces. They worry me too. As a human being and as a politician.

## 2. MAKING SCHLESWIG-HOLSTEIN A LAND OF WIND ENERGY

Excellencies, Ladies and Gentlemen,

I am speaking to you as the Minister-President of a very small *Land*, a German state situated between Hamburg and Denmark: *Schleswig-Hol-*

*stein*. If you are wondering what is special about Schleswig-Holstein I can tell you quite briefly: its function as a bridge between Central Europe, Scandinavia and the Baltic Sea region. Its uniquely beautiful coasts and landscapes. And 2.8 million people who love their native region and are at the same time receptive and cosmopolitan.

Very few of you here will be familiar with Schleswig-Holstein, for on the map this German state really does look small. And yet in one industry we are well known and play a major role: Schleswig-Holstein is the cradle of wind energy. In our Land between the North Sea and the Baltic Sea, at Germany's northernmost tip, the wind blows more than anywhere else in the republic. We have learned to make use of this gift of nature. The wind works for us: From wind we generate electric power. The wind turbines on shore were the first step. The second step is now to follow. For over the sea the wind blows more strongly and reliably than on land.

We have the technical means already. The first windmills are turning on the open sea. More will follow in the next few years. That shows we have set out into the age of renewable energy and have already progressed quite a long way on the road.

Other parts of the world are setting out on this road too. I see that our experience is meeting with great interest there. These topics take me abroad again and again.

I invite you to follow me in thought to Schleswig-Holstein. First of all, let us take a look at Schleswig-Holstein as the Land of wind energy.

The pioneering work was carried out nearly thirty years ago. When wind energy took its first cautious steps I was a young member of parliament in the *Deutscher Bundestag*. At that time there were already a number of people in our region who recognized the economic opportunities offered by using wind to generate electric power. I was one of them. And looking back I admit: we didn't make the political decisions of that time because we thought we could save the world with wind energy. No. That's not how it was. I was the member of parliament for a structurally weak region. The shipbuilding industry had major problems. The shipyard in my hometown was faced with insolvency. Eventually we had an idea: if nobody wants ships built, the men must build something else. The firm Vestas – now the international market leader in wind power plant – was just starting production. These pioneers in the field of alternative energy were looking for a suitable production site. The former shipyard was ideal. One thing we did know: this was a chance to save jobs. This was a chance to earn money. This was a chance to bring prosperity to our region. This was what motivated our activity at that time.

We created the basis for the wind energy boom with the Electricity Feed Act – now called the Renewable Energy Sources Act. Other states subsequently adopted this law. To this day it provides that every kilowatt-hour generated from renewable energy sources must be given priority acceptance by the operator of the grid and paid for at a fixed rate.

Nowadays our motivation is quite different. The economic aspects are no longer dominant, because we have experienced a shift of values in our society. It's true that there is still money to be earned with energy production in Schleswig-Holstein. But our activities are now based on ecological considerations.

The 'green electricity' balance in Schleswig-Holstein is remarkably good: Schleswig-Holstein exports electric power. We produce three times as much electricity as we consume ourselves. Last year we generated nearly one-third of the electric power in our region from renewable sources like wind, biomass and solar energy. In terms of figures that means we already produce nearly half of the electric power consumed by the local population from natural sources.

So we have achieved a lot. But we don't intend to stop there.

The goals we have set ourselves for the future are more ambitious still: in ten years we in Schleswig-Holstein intend to generate all the electric power we need from renewable sources.

Wind energy has become one of our most important industries: in Schleswig-Holstein we don't just install wind generators. We develop them too. They are built. And they are maintained. That has created highly skilled jobs for 7,000 people – more than we ever dreamt of in the early days of the industry. Experts from all over the world now come to our town of Husum to inform themselves about the latest trends.

Husum is my home town. But that isn't what leads me to mention it here. The little town on the North Sea coast has made a big name for itself in the world of wind power. In its own industry it has a reputation like Silicon Valley. Every two years, 24,000 expert visitors from 40 countries make their way to Husum for the exhibition 'Husum WindEnergy'. Just imagine: the town then has more visitors than inhabitants! Some even have to sleep in tents on the exhibition site because the hotels are totally booked up. But the experts like to come all the same. This leading international trade fair is a magnet.

### 3. SUPPORT FROM THE POPULATION – EXERCISING JUDGEMENT IN NEW ENERGY POLICY

Ladies and Gentlemen, Germany's supply of electric power must be safe and reliable, climate-friendly and affordable. That is what consumers justifiably expect politicians to ensure.

In practice this demand is often a cause of dispute.

Those who say energy must be 'safe and reliable' are thinking first and foremost of reliability. For the time being, wind and solar power with their natural fluctuations will need the support of other forms of energy. These include the three classic sources: coal, gas and nuclear power.

But: these are highly disputed energy sources. The public is less and less willing to accept coal, gas and nuclear power. And not only that: we want to get away from fossil fuels. And atomic power is at best only acceptable and convincing as a transitional technology.

So that means we have to step up our efforts. Considerably. The renewable energy sources must replace the fossil fuels reliably as soon as possible. The main requirement for that is new electrical energy storage systems.

The Land government of Schleswig-Holstein supports research in this field. At the Centre of Excellence for Wind Energy we link scientific institutions with industry in the search for a solution.

Linking: that is an important factor.

If we were to link up the different renewable energy sources over large areas we could meet our future energy requirements. Imagine joining up hydroelectric power from Norway with the planned German and Danish windfarms at sea. Renewable energy sources would then be coupled to ensure a reliable supply of electricity.

To achieve that we must think in broader terms.

To achieve that we have to overcome national boundaries. The states bordering on the North Sea have set out in that direction. They are examining how to put such a transnational power network into practice. We are talking about the 'North Sea Supergrid'.

I am convinced that, if industry found the courage to invest the necessary millions in this project, it would have a similarly trend-setting effect to the Desertec initiative. With solar power from the North African desert it is planned to lay the foundations of a sustainable global electricity supply by 2050.

Ladies and Gentlemen, If we want to realize ambitious plans for extending the supply of renewable energy we must do so with the goodwill of the population. Without it our energy policy is doomed to failure!

We are experiencing that in Schleswig-Holstein: no other German state has as many wind turbines per unit of area as we have. And we lead the field in production capacity per unit of area too, thanks to repowering; by that I mean the replacement of first-generation turbines with new ones.

If more space is to be given over to wind-power generators we have to realize what that means.

In the mid 1990s the nacelle of such a windmill, to which the rotor and the blades are attached, was at a height of about 60 metres. Modern installations now produce four times as much electricity. But they are also twice as high. At 120 metres they are nearly as high as St. Peter's Basilica – and at 180 metres the tips of the blades would tower above it.

I went up such a windmill last year with His Excellency Bishop Sánchez Sorondo. He knows what a wonderful view you get from up there. Most of Schleswig-Holstein's landscape is flat. These windmills are visible from enormous distances. Not everybody finds that attractive in a tourist region like Schleswig-Holstein: visitors come to us to enjoy our scenery and nature!

So it is not only coal-fired and atomic power stations that raise objections to enlarging the energy infrastructure. In my experience the renewable energy sources encounter problems of acceptance too. The wind noise made by the blades, the flickering shadows of the rotor in sunny weather, the blinking of the signal lights at night: nobody wants that close to their own home.

Ladies and Gentlemen, I have two answers to that.

One is that a further increase is only possible if we exercise good judgement. So we will collect the windmills which were spread out over the landscape in the past and concentrate them in areas where they cause less conflict. At the same time we are placing our faith in our considerable offshore growth potential – that is, out at sea.

My other answer is that the best way to eliminate objections is to involve the local population. Renewable energy lends itself to that because it is generated in smaller units and on a more decentralized basis than in power stations fired with fossil fuels.

Our experience with community windfarms has been very positive indeed. In these projects the local residents cooperate in order to invest jointly and achieve revenue.

I have already said that energy must be safe, reliable and climate-friendly. But at the same time it has to remain affordable. In Germany, every kilowatt-hour generated from sunlight, biomass or wind will be

paid for at fixed rates for 20 years. That makes sense for a transition period – until electric power can be generated from renewable sources at prices acceptable to the market.

So this law provides for decreasing payments: the remuneration is reduced each year. Moreover, the renewable energy sources must be used where they are the most economical solution.

What I mean is: electricity should be generated by solar power where the sun shines. Similarly, electricity from wind power makes most sense where the wind really blows. And in its geographic position between the North Sea and the Baltic Sea, Schleswig-Holstein is destined by nature to perform this task.

#### 4. CONFLICTING PRIORITIES OF PROTECTING THE CLIMATE AND FEEDING THE WORLD'S POPULATION

We are finding more and more examples that the idea of achieving ecologically sound activity through financial incentives may have undesirable side-effects. I'm experiencing that in Schleswig-Holstein. Let us forget wind power for the time being and turn our attention to energy production from biomass. That ranks as a sustainable energy source, too.

In Schleswig-Holstein the fixed remuneration for feeding electricity from biomass into the grid is leading to competition for agricultural land. Farmers who want to grow food are no longer able to compete with those who produce biomass.

Farmers who also grow fuel plants are able to pay higher lease rates for land, whereas those who produce food find themselves in difficulties. In this way, less and less is being produced for the table and more and more for our automobile tanks.

That may make sense from the point of view of business, but it is certainly not sustainable.

Ladies and Gentlemen, Schleswig-Holstein has become a pioneer of ecological energy production. Our region has taken up the challenge of climate change. Nevertheless, I ask myself: Are we on the right course at present? In our discussion of the climate, which largely takes place in the wealthy industrialized countries, are we not forgetting something of essential importance?

The production of biomass from maize makes it very plain how energy production from a basic food can lead us into an ethical dilemma.

Let me illustrate that with an example. A human being needs 221 grams of maize a day in order to survive. From the same amount it is possible to produce 85 cubic centimetres of biofuel. That is just enough to drive a modern Italian car a good 900 metres. Roughly the distance, perhaps, from your home to the nearest baker's shop.

Or to put it differently: the amount of energy in one tank filling is roughly equivalent to the calories a human being needs in order to survive for a year.

That is a fundamental thought: while we in the Western world are seeking to solve thousands of problems, the hungry masses of the world have one problem only: *their struggle for survival*.

Ladies and Gentlemen, the underfed have to compete with our problems in their fight for survival. They have no lobby to support them. That concerns me deeply as an individual who would like to live by the principles of Christian charity and solidarity.

The world's population continues to increase by about 80 million a year. By the year 2050 it will have grown from the present 6.9 billion to over 9.1 billion. There will be a huge increase in the demand for food and animal feed in respect of both quantity and quality. The agricultural scientist Joachim von Braun described that very emphatically a year ago, before this same audience.

About a billion people around the world are undernourished. At the same time the demand for energy is increasing, and with it the price. A rise in the price of energy makes agricultural production more expensive. Agricultural raw materials are more and more often being used to make biodiesel and bioethanol.

The prefix 'bio' is misleading. It sounds like ecologically acceptable production, like a good conscience. If we were honest we would speak of agrofuel: fuel made from sugar cane, rapeseeds, soybeans, maize and wheat. Or to put it differently: food is converted into fuel because direct subsidies or tax exemptions make it financially worthwhile!

That is anything but ecologically sound and sustainable.

As much as 4,500 litres of water alone are needed to produce a single litre of bioethanol. By comparison: 900 litres of water are needed to produce a kilogram of the staple food maize. If more land is to come under the plough worldwide, that means more trees have to be felled in the tropical rainforests – and not only there.

That is bad for the diversity of species. That is bad for our climate. And it is bad for the global carbon balance.

The competition between agriculture for food growing and agriculture for energy generation is bound to affect the price of food. The UN expert Jean Ziegler put this in a nutshell: 'Biofuel from food is a violation of human rights'.

Full tanks and empty stomachs?

In my opinion we have an ethical and moral obligation to ensure that enough food is produced for all the people on this earth, now and in the future. Everyone must have access to food, clean water and energy at reasonable cost, today and tomorrow. We must ensure that these commodities are distributed fairly. We must make greater efforts to eliminate poverty and intensify agriculture.

It can be done. It is up to us.

## 5. THE STEPS TOWARDS A CHANGE OF HEART

Ladies and Gentlemen, I suggest we take steps towards a change of heart:

- German and European agrofuel policy must be altered. We need less subsidies and more market.
- We must set new points of emphasis in research and development and step up agricultural and energy research. In Schleswig-Holstein we have established a centre of excellence for the use of biomass. We want to find out how to reconcile protection of the climate with a universal supply of food. We need revolutionary technology to produce a new generation of fuels from waste and superfluous materials without this having an impact on food production.
- And we should do some re-thinking about green genetic engineering. To my mind it is indispensable if we want higher production rates, reliable harvests and less chemicals on our fields. With green genetic engineering we can increase yields and make plants more resistant to drought, pests and diseases.
- We must no longer neglect agricultural and food policy in the context of development cooperation. Agricultural subsidies by the industrialized countries have slowed the increase in productivity in the developing countries. There are African states that were exporting agricultural products 20 years ago and are now having to import food. We must reverse this trend. Agricultural know-how helps developing countries to help themselves and strengthens rural areas.

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- And finally we must increase our research capacity in the field of established renewable energy forms too. Our goal must be to make wind and solar power reliable sources of energy. To do this, we in Schleswig-Holstein have set up a centre of excellence for wind energy and built a research platform in the North Sea.

One more word to you:

Schleswig-Holstein has a highly productive agricultural sector and efficient institutions for agricultural science. If we use these as a basis for setting the right course, we shall have made at least some contribution to securing the world's supply of food.

To secure an adequate supply of food throughout the world and to prevent climatic disaster while ensuring a reliable supply of energy: these are central and vital challenges to the global community. I myself am convinced that this global problem can be solved; in fact I am convinced that a change of heart is possible!

With wind energy we have already set an example.

Thank you.

## AGRICULTURE, FOOD AND NUTRITION RESPONDING TO THE CRISES

JOACHIM VON BRAUN

*Agriculture, food and nutrition must be part of a necessary policy re-planning, because it matters most for the poorest*

Hunger increased in the context of the inter-linked food and economic crises of 2007-2010. The food crisis actually came first while overlapping with the onset of the economic recession, and may actually have had some role in the onset of the latter due to the inflationary forces of food (and energy) prices to which macro policies reacted. Not only food and energy markets but also food and financial markets have become closely linked and these links pose added risks for the poor, increasing their vulnerability. To remind about basic concepts: food and nutrition security depend upon the availability of food (through production and trade), access to food due to purchasing power, and the utilization of food by people, including their health situation, which transforms availability and access into more or less satisfactory nutrition. The food and economic crisis was triggered by and had adverse impacts on all three: availability, access and utilization of food.

The chronic food and nutrition crisis is deepening, as high and volatile food prices and global recession undermine the food and nutrition security of the poor and threaten their livelihoods. The food price crisis was the consequence of neglect of investment in agriculture in developing countries, inappropriate agriculture energy subsidization policies in industrialized countries and triggered by adverse weather events and exasperated further by inappropriate policies, such as export restrictions, lack of regulation of commodity trade that increased speculation (von Braun 2009).

*The food and nutrition crisis expanded and deepened and actions taken so far are not sufficient to prevent the next acute crisis, let alone reduce the chronic hunger problems*

Global progress in combating malnutrition has been slow in past decades, with dramatic differences among countries and regions. The 2008 Global Hunger Index (GHI)<sup>1</sup> score fell to 15.2 compared to 18.7 in 1990, indicating a slight improvement in the overall hunger situation. But the absolute number of undernourished people in developing countries actually increased from 823 million in 1990 to 848 million in 2002-05, and 963 million in 2008 (FAO 2008) and now probably to more than one billion. Even before the food price crisis in 2007-08 hit, roughly 160 million people were living in ultra poverty, on less than 50 cents a day. The poorest have been left behind.

The prices of staple foods that the poor depend on skyrocketed during 2007-08. At their peak in the second quarter of 2008, world prices of wheat and maize were three times higher than at the beginning of 2003, and the price of rice was four times higher. In response to high food prices, poor households had to limit their food consumption, shift to even less-balanced diets, and spend less on other goods and services that are essential for their welfare, such as clean water, sanitation, education, and health care (von Braun 2008). Food price hikes have also worsened micronutrient deficiencies, with negative consequences for people's nutrition and health, such as impaired cognitive development, lower resistance to disease, and increased risks during childbirth for both mothers and children. Since children's nutrition is crucial for their physical and cognitive development and for their productivity and earnings as adults, the health and economic consequences of insufficient food and poor diets are lifelong – for the individuals as well as for the society. Hoddinott *et al.*'s (2008) article shows that men who benefitted from a randomized nutrition intervention when they were young children earned wages that were 50 percent higher than those of nonparticipants three decades later (Hoddinott *et al.* 2008). Thus, it must be assumed that even when a multi-year price shock ends, the adverse consequences for the poor and food insecure continue for decades.

People in more than 60 countries turned to the streets in protest in 2007 and 2008. IFPRI estimates that recession and reduced investment in agri-

<sup>1</sup> The GHI of IFPRI is a combined measure of three equally weighted components: (i) the proportion of undernourished as a percentage of the population, (ii) the prevalence of underweight in children under the age of five, and (iii) the under-five mortality rate.

culture could raise international grain prices by 30 percent and push 16 million more children into malnutrition in 2020 compared with continued high economic growth and maintained investments (von Braun 2008). Existing land and water constraints, as well as further challenges for natural resources such as climate change, make the needed task of doubling food production in the next four decades more challenging.

### *Taking actions for change*

The necessary response to the food crisis is multifaceted, including actions in production, consumption, as well as trade and grain reserve policies. The world also needs to reduce waste in consumption and food processing. However, the often stated idea that the world food problem is just a problem of distribution, i.e. that there is enough food in the world for all and that it just needs to be shared more fairly and equally, is a gross simplification. The root cause of the food crisis was lack of agricultural productivity. Distortions in markets and policy failures followed as secondary effects. Both the productivity deficiencies and the institutional arrangements that fail the poor must be addressed. And in addition, hunger and under-nutrition need to be addressed directly with new and strong actions.

This paper focuses mainly on the first – necessary re-planning of the the journey in production technology policies and the opportunities of biotechnologies, because policy change is overdue to change policy in this field. In the second area of action – access to food – market and policy failure needs to be corrected by institutional change. The third area of urgent change is nutrition action, as that vital area has been neglected for a long time and was further undermined by diverting attention to crisis management. Many children's lives are ruined as a consequence.

### *Action Area 1: Agricultural technology for food and nutrition security*

Numerous studies have shown that spending on agricultural research and development (R&D) is among the most effective types of investment for promoting growth and reducing poverty. However, public R&D investments have been stagnating since the mid-1990s, and the gap between rich and poor nations in generating new technology remains high (Pardey, Alston, and Piggott 2006). The current resources are hardly enough to work at the frontiers of new science, and the recent financial crunch further constrains the availability of capital for agriculture sci-

ence in parts of the developing world. To enhance agricultural productivity, investments should be scaled up in the areas of R&D, rural infrastructure, rural institutions, and information monitoring and sharing. Doubling investments in public agricultural research from US\$5 to US\$10 billion would significantly increase agricultural output and millions of people would emerge from poverty. If these R&D investments are targeted at the poor regions of the world – Sub-Saharan Africa and South Asia – overall agricultural output growth would increase by 1.1 percentage points a year and lift about 282 million people out of poverty by 2020 (von Braun, Fan, *et al.* 2008).

Part of this action should be *modern biotechnology, including genetically modified (GM) crops*, appropriately tested and used to comprehensively address food and nutrition insecurity of the poor. New research insights exist that now suggest wider and faster utilization of these contentiously debated technologies. Food and environmental safety concerns have been well addressed in many developing countries in recent years. Genetically modified foods currently available on the international market have passed risk assessments and are not likely to present risks for human health, stated the WHO (2009). The technology seems over-regulated. Also, the fears that multi-national corporations dominate seed systems and would exploit small farmers is less and less relevant as developing country-based corporations and public sector research entities have entered the scene, for instance in China, India, Brazil. Still, further support of public research on GM crops is called for to assure that non-commercial traits that serve the poor are actually developed quickly.

The three pathways for food and nutrition security pointed out above – availability, access, utilization – are all positively contributed to by GM crops (see the comprehensive assessment by Qaim 2009). Specific examples on GM contributions to food and nutrition security are described below.

*Reduction of crop losses and improved efficiency:* A significant proportion of the potential world harvest is lost to weeds, animal pests, and diseases. A sizeable portion of these potential losses is avoided through chemical pesticides and other pest-control strategies. Actual losses are higher in developing countries than in developed countries, because pest pressure in tropical and subtropical climates is often stronger than in temperate zones. Moreover, given more severe technical and financial constraints, pest control is often less effective in developing countries. Positive yield effects of pest-resistant crops are expected to be higher in developing countries (Qaim and Zilberman 2003). Insect resistance was among the first GM trait

to be commercialized in some crops, but fungal- and bacterial-resistant GM crops are also emerging. Important are also efficiency gains in animal feed to reduce the food-feed competition. China recently issued bio-safety certificates for its nationally-developed proprietary phytase maize. Phytase maize will reduce pollution from lower phosphate in animal waste and increase feed use efficiency.

*Yield increase through crop tolerance to abiotic stresses:* GM traits address higher plant tolerance to various abiotic stresses such as heat, drought, flood, coldness, or soil salinity. Such technologies could also contribute to higher and more stable yields, especially in regions affected by erratic weather conditions. Developing countries could benefit more than developed countries, because of higher weather variability and limited access to irrigation and other risk-reducing technologies. The first drought- and heat-tolerant GM crops are expected to be commercialized within the next five years and could significantly raise agricultural productivity and thus ensure food availability. Rice that survives submergence due to floods – a product of biotech, not GM – has already been developed and is relevant for river deltas where many of the world's poor live (Bangladesh, etc.)

*Increasing small farmers' incomes:* a large proportion of the food-insecure world population is part of the small farm communities of the developing world. GM technologies can be suitable to raise incomes in the small farm sector. Inbuilt in the seed, they are scale neutral and not just for big farmers. Bt Cotton has significantly increased small farmers income in large parts of India, thereby reducing poverty and food insecurity. China has recently announced the first steps toward commercialization of Bt rice. The technology has been field tested extensively in field stations and on farms. The available data are in line with results for already commercialized Bt crops: insecticide-reducing and yield-increasing effects can lead to significant economic and social benefits (Huang *et al.* 2005).

*Increasing nutritional value of foods for the poor:* the food price crisis has further undermined healthy diets for the poor. Until income growth among the poor permits sufficient purchasing power to afford healthy diets complementary actions are needed. A complementary strategy is biofortification, that is, the breeding of staple food crops for higher micronutrient contents. While this partly builds on conventional breeding, GM approaches are promising when certain micronutrients are absent from a crop or not available in sufficient amounts.

*Rice in Asia:* A case in point is rice, where the endosperm of conventional grain does not contain any beta-carotene, which is a precursor of vitamin

A. Hence, GM techniques were used to develop Golden Rice, which now contains significant levels of beta-carotene. It is no longer just a hope but progress in research shows that Golden Rice, if consumed at normal quantities, would make a big difference. Using a disability-adjusted life years (DALYs) approach, Stein *et al.* (2008) calculated the disease burden associated with Vitamin A Deficiency (VAD) in India. Widespread consumption of Golden Rice could reduce the burden of VAD by 59%, which includes saving almost 40,000 lives every year. The positive effects are most pronounced in the poorest income groups. Golden Rice is a humanitarian project where seeds will be distributed without a technology fee. According to the projections by Stein *et al.* (2008), the cost per DALY saved through Golden Rice is in a magnitude of 3 US\$, which is very low. Similar effects could be achieved in other parts of Asia.

*Sorghum and cassava in Africa:* Since 2005, a consortium of 11 organizations has been working to develop a biofortified variety of African sorghum – a crop very relevant for poor people (Fiedler 2009). An *ex ante* analysis of the impact of this crop was based exclusively on the functional health impacts produced by increasing the amount of vitamin A and the bioavailability of iron and zinc.

It is estimated that its benefit/cost ratio is 4. According to criteria established by the World Health Organization and the World Bank, this is a very cost-effective health intervention. A similar analysis for cassava – one of Africa's most important staple crops – is even more advantageous (Fiedler 2009). It is estimated that the net present cost per disability adjusted life years (DALY) saved of this biofortified crop is \$33.

#### *Action Area 2: Making food markets work and reduce extreme price volatility*

Food price volatility affects the poorest the most. In the food price crisis many commodity exchanges closed or food trade was discontinued. Markets failed. To prevent extreme volatility, it is essential to ensure open trade, and transparent, appropriately regulated market institutions that identify prices reliably. Excessive speculation opportunities in food commodities which did play a role in the food price crisis should be curbed by regulations, i.e. by *increasing costs of speculation* for non-commercial traders.

Two global collective actions for food security are needed: first, a small, independent physical reserve should be established exclusively for emergency response and humanitarian assistance. Second, a *shared and virtual reserve and intervention mechanism* should be created to help avoid extreme

price spikes. The organizational design of the virtual reserve would include a high-level technical commission that would intervene in futures markets and a global intelligence unit that would signal when prices head toward a spike (von Braun and Torero 2009). This reserves concept is not a price stabilization fund, but it is an institutional tool for risk reduction (to prevent extreme spikes).

The virtual reserve calls for a coordinated commitment by the group of participating countries. Each country commits to supplying funds, if needed, for intervention in grain markets. The resources needed are promissory and not actual budget expenditures. The concept of virtual reserves is based on signaling theory where a strong commitment is required to increase the risk assumed by speculators in entering the market, which in turn, would increase their discount rate and, as a result, lower the probability of them participating excessively in the food market. The size of this commitment should be significant enough to have a strong signal in the market.

Discussion continues about international grain reserve policies. The G8/20 raised this as an option to be further explored. Regional policy bodies, such as ASEAN, SARC, and African regional and sub-regional bodies have discussed joint reserve policies. The initial reservation against a new institutional arrangement has declined after it became clearer to policy makers that there is a serious institutional vacuum at the international level. The existing agricultural and food organizations (FAO, IFAD) have the capacity to address supply issues (before crises), and emergencies (in and after crises WFP), but none can address market volatility itself; the WTO has no such mandate either. The issue needs to move from debate to action.

### *Action Area 3: Expanding social protection and child nutrition programs*

To protect the basic nutrition of the most vulnerable and improve food security, agricultural growth and reducing market volatility must be accompanied by social protection and nutrition actions. Protective actions are needed to mitigate short-term risks while preventive actions are needed to avoid long-term negative consequences. Protective actions include conditional cash transfers, pension systems, and employment programs. Preventive health and nutrition interventions such as school feeding and programs for improved early childhood nutrition should be expanded to ensure universal coverage. As such, social safety nets not only ease poverty momentarily, but also enable growth by allowing poor households to create assets,

and protect their assets. Interventions need to be developed and include the following options:

*Conditional cash transfers (CCTs):* These programs, which condition transfers to households based on their meeting certain requirements like sending children to school, have proven successful in reducing poverty in the short run (through cash transfers) and in the long run (through the human capital formation that they encourage). They work particularly well in countries with low school attendance and an adequate schooling infrastructure. They are not a magic bullet, however – they do not work in every country and alone they are not sufficient for reducing poverty sustainably. Early childhood nutrition actions should be connected to them where needed. The large progress in nutrition in Mexico and Brazil is to a great extent due to these transfer programs.

*Social security:* This tool has been shown to address the vulnerability faced by the young, the unemployed, and the elderly. In South Africa, for example, social security benefits for parents with young children and for the elderly have greatly reduced poverty. For social security to work in low-income countries, national governments need to increase financing from general taxation, separate social security from labor market status, and create institutions to administer social security programs. The need for administrative efficiency and good governance are two key challenges in implementing programs. Introduction of an efficient and fair taxation system is needed for that, too.

*Market-based or civil society-based insurance:* In providing insurance for the poorest, it is useful to start with group-based informal insurance that is already in place. Doing this reduces the costs of providing insurance and ensures that new forms of insurance do not weaken these groups that are already effective at dealing with some types of risk. There is often a trade-off between the provision of insurance and credit, and micro-credit and micro-insurance should be designed together. One product will not fit all problems because different types of risk have different challenges. To provide health insurance to the poorest, schemes should leverage the large amounts that poor people spend on health care out of pocket. Developing a private cooperative health insurance scheme and contracting the provision of health care based on performance is one way to do this.

Ultimately, a mix of health and nutrition approaches is needed. The goal is to ensure that the poorest households do not find themselves constrained in making health and education decisions. Improving the nutritional status of children will also require improving the nutritional status of their mothers.

Despite the recent improvement in child malnutrition in South Asia, the region still has the highest prevalence of underweight children in the world. The main reason proposed to explain a higher child malnutrition rate in South Asia than in poorer Sub-Saharan Africa is that South Asian women's nutrition and feeding and caring practices for young children are inadequate. Women's rights, information and education opportunities need strengthening.

### *Conclusions*

Prioritization, transparency, and accountability are crucial for successful implementation of agriculture, food and nutrition policy. Related governance deficiencies in many developing countries must be addressed, as well as global governance of food which currently does not deliver the necessary public goods for food security to the poor. The food crisis needs to be responded to by actions that require overcoming accustomed mainstream thinking, such as about biotechnologies, market regulation, and social security. Food and nutrition security need to be given higher priority.

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## THE AUTOMOBILE SECTOR

LUCA CORDERO DI MONTEZEMOLO

A mio avviso il ruolo di incontri come questo, in un'Accademia Pontificia che guarda avanti, non è solo quello di condividere delle analisi, ma soprattutto di condividere delle terapie; la discussione culturale e scientifica è sempre interessante ma ancor più interessante, e soprattutto doveroso, è rivolgersi al futuro suggerendo delle soluzioni.

Parlando dell'industria automobilistica, ed in generale dell'industria mondiale, dovremmo partire da una verità: negli ultimi tempi ci siamo trovati con una rapidità straordinaria di fronte alla più grande crisi, finanziaria prima ed economica poi, dai tempi del dopoguerra. Nel nostro mestiere, quello dell'automobile, abbiamo avuto degli anni difficili e delle crisi importanti, dopo la guerra del Kippur o nel 1993, ma fu qualcosa di differente. Innanzitutto furono crisi specifiche del settore automobilistico che coinvolsero aree molto precise del mondo e non globalizzate come è stato per quest'ultima. Questa nuova crisi è nata fondamentalmente dall'ingordigia del mondo finanziario e delle banche americane, che hanno fatto sì che, alle quote di mercato, ai prodotti, alle fabbriche, all'economia reale, si sostituisse l'economia della carta e della speculazione, un'economia che non si basa su reali valori.

Nell'industria automobilistica mondiale – uso un termine volutamente provocatorio, “paradossale” – la crisi paradossalmente ha causato una trasformazione assolutamente straordinaria basata su tre grandi elementi: l'organizzazione del lavoro, le tecnologie, i mercati.

Per organizzazione intendo l'attenzione al patrimonio più grande di un imprenditore: le donne e gli uomini che lavorano nelle aziende. Ciò significa formazione, crescita professionale, *improvement* della qualità dell'ambiente di lavoro e possibilità di organizzare il lavoro in modo più valido, più dignitoso e non solo più efficiente. In questi ultimi tre anni l'organizzazione del lavoro nell'industria dell'automobile ha visto una trasformazione epocale.

Un secondo aspetto, altrettanto importante e che ha vissuto un'incredibile evoluzione negli ultimi anni, è rappresentato dalle tecnologie: le tecnologie legate ai consumi, a nuovi propellenti e benzine e le tecnologie legate ai costi. Oggi la grande sfida dell'industria automobilistica è di condividere il più possibile componenti comuni, diminuendo il costo del prodotto di fronte ad una competizione straordinaria dei prezzi. Si tratta di tecnologie che hanno permesso enormi progressi anche in altri tre settori: sicurezza, durata del prodotto e *time-to-market* ovvero il processo che va dal foglio bianco del progetto alle vetture pronte per essere vendute. Oggi l'industria dell'automobile ha dimezzato i tempi, che nel nostro mestiere, ripeto, si chiamano *time-to-market*, dal progetto alla vettura pronta. Ciò ha comportato un completo rinnovamento dei parchi auto ed un miglioramento delle vetture rispetto a prima in termini di minor inquinamento e maggior sicurezza.

Il terzo elemento da sottolineare riguarda i mercati e quindi i clienti. La globalizzazione ha aperto opportunità straordinarie a tutta l'industria. Vorrei citare in proposito un passaggio, veramente interessante, della Lettera Enciclica *Populorum Progressio* di Papa Paolo VI del 1967, in cui Sua Santità segnalava già allora l'urgenza di affrontare le sfide della giustizia sociale in una prospettiva globalizzata e raccomandava soluzioni che non rimanesse all'interno dei singoli paesi ma che coinvolgessero tutto il mondo e tutti gli attori della politica industriale: imprenditori, mondo finanziario, mondo della politica e, logicamente, i lavoratori. Il mercato si è aperto ora improvvisamente; nel dopoguerra, con il boom europeo e americano dell'industria dell'automobile si viveva praticamente di Europa, Giappone e Stati Uniti. Oggi il più grande mercato dell'automobile del mondo è la Cina; il Brasile sta crescendo in maniera straordinaria proprio in questo settore, come l'India e l'Estremo Oriente nel suo complesso. Ciò comporta da un lato una concorrenza straordinaria, ma anche, per imprenditori capaci, un'opportunità di crescita, di trasformazione della propria azienda, di affrontare un mercato mondiale con chiarezza di idee, chiarezza di obiettivi e soprattutto con una grande potenzialità di accordi tra varie aziende automobilistiche per raggiungere quell'obiettivo, cui accennavo prima, di componenti in comune per abbassare i prezzi. Questo apre uno scenario nuovo o meglio lo ha già aperto. Abbiamo visto accordi tra aziende automobilistiche importanti come Fiat e Chrysler; Renault e Mercedes, e penso che avverrà lo stesso tra BMW e Peugeot e avremo necessità di altri accordi al fine di avere piattaforme e componenti in comune e abbassare i prezzi di fronte ad una competizione così forte.

Questa prospettiva globale vorrei vederla per un momento legata all'industria italiana perché, mai come in questo momento, avremmo bisogno di guardare con più attenzione ai problemi reali del paese e meno a cose che sono lontane dalle esigenze delle famiglie e dei lavoratori. Vorrei fare un esempio che sarà fondamentale nei prossimi anni e che riguarda il fisco e le tasse. Fatto 100 lo stipendio che un'azienda paga ai propri collaboratori e alle proprie collaboratrici, nelle tasche di chi lavora finisce solo il 50%. Tutto il resto sono tasse. Il che fa sorgere due domande: primo, è giusto che un lavoratore dipendente, che non evade le tasse perché gli vengono trattenute nella busta paga, debba pagare una quota così alta, pari al 50% dello stipendio? Io, lavoratore dipendente in un paese in cui pagare le tasse non è così popolare come in Italia, mi domando: quel 50% che mi viene trattenuto, dove va? Cosa me ne viene indietro? Se noi mettiamo insieme queste domande, che debbono comportare una minore tassazione sul lavoro dipendente, ci rendiamo conto che la crisi la dobbiamo affrontare guardando la realtà e dobbiamo ammettere, soprattutto in queste sedi, che il disastro dell'ingordigia finanziaria ha portato almeno un vantaggio: quello di far tornare l'industria ed il mondo economico nel suo complesso con i piedi per terra.

In Paesi come la Germania – il più importante in Europa in termini di manifatturiero, in cui l'industria e la cultura industriale hanno una forza straordinaria – e come l'Italia che, a differenza di Spagna ed Inghilterra, ha gestito la crisi in maniera accettabile proprio per la forza dell'industria e del manifatturiero, questo nuovo processo sta finalmente contribuendo a riportare in primo piano i prodotti, la qualità, la tecnologia, le quote di mercato, la politica commerciale, la politica industriale, l'innovazione, la formazione dei propri collaboratori.

Credo davvero che non sia giusto che chi investe, lavora e produce veda un divario così straordinario di stipendi e di numeri tra il mondo speculativo della finanza e della carta e il mondo di chi si confronta tutti i giorni con il prodotto, i mercati, i clienti, gli investimenti e l'innovazione. Paradossalmente, per il nostro mestiere ma non solo, la crisi ha aperto delle finestre che avrebbero dovuto aprirsi prima ma che, fortunatamente, ora si sono rivelate.

Qui subentra un altro grande tema a me caro: la responsabilità sociale dell'imprenditore. Come presidente della Ferrari, ho avuto grandi soddisfazioni nel vincere, con una buona collaborazione tra Italia e Germania, molti campionati del mondo di Formula 1; ma se vi devo dire la soddisfazione maggiore che ho avuto è stata quella di vincere un importante premio, *The Best Place to Work in Europe* (il miglior posto dove lavorare in Europa)

risultato di una ricerca del *Financial Times* in collaborazione con un importante istituto svedese su di un campione di operai, impiegati e dirigenti su aspetti come la soddisfazione, la motivazione, la qualità della vita in fabbrica e la possibilità di crescita all'interno delle aziende. Anche per questo mi fa piacere che in questa sede si parli di *Education*, che per il nostro mestiere, per il nostro Paese e non solo, è *by far* la priorità numero uno; *by far*, perché credo che noi tutti sogniamo un paese che si basi sul merito, sulla volontà di premiare chi è più capace, indipendentemente dal colore della pelle, dal paese di provenienza o da qualsiasi altro aspetto che non sia il merito. Nell'industria privata di qualunque settore chi non pone al centro il merito non sa fare il suo mestiere. Per me la più grande soddisfazione è la crescita all'interno dell'azienda: vedere entrare ragazzi in azienda magari come operai, o appena laureati, e metterli in condizioni, se sono capaci, di crescere: ecco da dove viene la grande forza di un'economia reale che permette di valutare e giudicare le persone sulla base dei risultati. Quando la Fiat era vicina alla bancarotta non era colpa del sindacato, dell'11 settembre o altro. È stata colpa del fatto che la Fiat non produceva macchine sufficientemente competitive rispetto alla concorrenza. Ecco perché oggi l'imprenditore – e lo dico scusandomi, perché è una provocazione, lo so, è paradossale – finalmente torna a concentrarsi facendo qualunque prodotto: le automobili, le biciclette, la pasta, i dentifrici, la cioccolata fondandosi sulle tre priorità di qualunque imprenditore: i propri uomini e le proprie donne – il più grande patrimonio – i propri prodotti, i propri clienti. Questa è la sfida globale, è una sfida di qualità, di organizzazione, di innovazione a 360°. Non si tratta solo di innovazione del prodotto, ci mancherebbe altro. Un imprenditore che non focalizza la sua attenzione sul prodotto non sa fare il suo mestiere ma non è solo l'innovazione di processo, in fabbrica, sui macchinari, nella produzione; è un'innovazione culturale all'interno della propria azienda, nell'organizzazione, nell'affrontare i mercati, nella formazione, nel marketing e nella comunicazione. È un'innovazione a 360°, quella stessa cultura dell'innovazione che ognuno di noi vorrebbe fosse la priorità dei nostri Paesi. Noi viviamo in un paese, quello italiano, in cui il 38% dei figli di operai nasce figlio di operaio e muore figlio di operaio; in cui il 45% degli architetti sono figli di architetti. Questi sono gli aspetti che un imprenditore moderno deve affrontare anche come responsabilità sociale: la crescita delle persone, il rapporto con il territorio ed anche il rapporto con i fornitori. Il nostro mestiere si basa su tante, tante piccole aziende, italiane, tedesche, francesi, giapponesi, che hanno bisogno di tecnologia e dobbiamo rafforzare il rapporto con i fornitori perché portano idee, qualità

e tecnologia e difatti il concetto di partnership con i fornitori sta diventando fondamentale nella nostra industria.

Vorrei ora richiamare la vostra attenzione su un ultimo punto.

La trasformazione delle aziende significa, purtroppo, perdita di posti di lavoro. È un dato di fatto. La crisi ha diminuito in maniera clamorosa la domanda, si deve produrre di meno e purtroppo si ha bisogno di meno personale. Ma ecco un'altra opportunità di evoluzione economica e sociale: attraverso moderni ammortizzatori sociali si possono aprire nuove porte, per i giovani e i lavoratori, diverse da quelle tradizionali. È lo stesso discorso quando un giovane inizia un lavoro in un'azienda: oggi non possiamo più pensare che farà quello stesso mestiere per tutta la vita. Un paese moderno oggi deve dotarsi di ammortizzatori sociali moderni perché, insieme alla trasformazione dell'industria questo momento può significare una generale evoluzione del Paese e perché abbiamo bisogno, tutti, particolarmente nel nostro mestiere, di reperire risorse per gli investimenti. I fondi per la creazione degli asili nido interni alle aziende, ad esempio, sono necessari perché significano maggiore occupazione femminile permettendo a tante donne di lavorare più serenamente. Vediamo poi quanto è importante oggi un *continuous improvement* in termini di formazione. Le tecnologie richiedono formazione e training continui, pensate nel nostro mestiere ai nuovi materiali e alla necessità di lavorarli in modo sempre diverso; molte sono le risorse necessarie per essere competitivi. Quando spesso mi sento dire che non ci sono denari per gli investimenti, un po' provocatoriamente mi rivolgo ai miei interlocutori ricordandogli i sacrifici che stanno facendo le famiglie dei nostri collaboratori, quelli che pagano il 50% di tasse ogni mese, ed i sacrifici che fanno gli imprenditori che, se non riescono a reperire risorse per gli investimenti, dovranno chiudere la propria azienda. Ecco quindi la necessità di uno sforzo comune, la necessità per gli imprenditori di trasformare le aziende, la necessità per i paesi di dotarsi di strumenti che aiutino l'evoluzione delle aziende e quindi del paese con particolare attenzione ai giovani.

Nel nostro mestiere quello che sta avvenendo in tutto il mondo è epocale, e pensate che tra qualche anno, e non molti, avremo macchine ibride, macchine elettriche, macchine che consumano e inquinano sempre meno ed avremo prodotti giusti per i singoli mercati, avremo un'industria globale che condividerà sempre di più la ricerca, l'innovazione, le tecnologie ed i componenti.

Il pensiero conclusivo è che le crisi spesso sono dei sintomi: sintomi costosi e dolorosi che segnalano anche le debolezze delle architetture isti-

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tuzionali, nazionali e internazionali che dovrebbero rimuovere le imperfezioni dei mercati. Da una politica lungimirante, da una politica che guardi avanti, che scelga, che decida, che affronti, che sia consapevole della velocità del mondo, da una politica lungimirante ci attendiamo la capacità di capire le debolezze e curare il cambiamento.

Il vero imprenditore moderno sarà il primo alleato di una politica responsabile che affronti e curi, con coraggio e lungimiranza, le debolezze emerse da questa crisi. Grazie.

## FAMILY BUSINESS IN GERMANY

PATRICK ADENAUER

Thank you, Mr Chair. Besides my job as an entrepreneur together with my brother in a construction and real estate development company, which is an old family business, I am chairing the association of family-owned businesses in Germany. Hearing the discussion yesterday afternoon and this morning I think it would be of interest to talk about what family business means in Germany and what we are going to see in the near future and how to solve the problems out of the crisis.

I head, together with my brother, a 137 year old real estate development and construction company, where we had to overcome a series of economic crises. When I entered the company in 1989 there was no German unity yet and the construction industry was in a terrible crisis but we did seize the opportunity in order to bring about total restructuring. Now we have been transformed into a company that renders services and we have always managed to come to grips with economic ups and downs. Through the 90s and in the beginning of this century we introduced a tremendous amount of flexibility, partly by shifting jobs abroad, but also through enhanced innovation and this is one of the reasons why we have managed to overcome the present economic crisis so well. The construction industry itself is a very cyclical branch. We entered the year of the crisis 2009 still with high order levels. 2010 will be more challenging, because of a significant fall in the demand for commercial and office buildings. On the other hand we do see now a rising demand in apartment buildings because of inflation fears and low interest rates. Many people and also institutional investors intend to invest in apartments. So I am partly optimistic for 2010 and a lot for 2011.

However, I think what is of much greater interest for you is to listen to what family businesses in Germany is about. The association that I lead is called 'Die Familienunternehmer – ASU e.V.'. It has roughly 5,000 members – all are entrepreneurs who employ in total 2 million people and

have a yearly turnover of almost 300 billion euros – and was founded in 1949 as an outcome of the experiences in the Weimar Republic and the Third Reich. The experience was that economics in pre-war Germany was very intertwined with the political class and that politics was pursued in view of large enterprises and capital markets. Following this tradition on the other side the big industry associations BDI and BDA were founded in the young Federal Republic. These both associations followed a contraposition to the owner enterprises in looking out for building cartels and anti competition legislation.

Contrary to that I think competition, responsibility, ownership and freedom are the key and founding principles of our 'Soziale Marktwirtschaft'. Therefore it needed a new antitrust law like the US had before. Minister Ludwig Erhard supported by our association fought very hard for this legislation from 1949 on, but the powerful BDI and the other branch associations always fought against this antitrust legislation.

Why was it that way? Well, it is easy to run a company without or, at least, with little competition and to gain power in the hands of a few lucky families like we see it in Greece nowadays. My grandfather Konrad Adenauer had to make a decision either to follow the BDI with its old ideas or to follow his Minister Ludwig Erhard. Finally Erhard won and in 1957 the antitrust law was set in place.

This was a big success because this legislation enabled the German Mittelstand to grow beside the still necessary big industry groups and be a driving force to stabilize the German economy up until today. As a heritage my association is still lobbying very much against subsidies. We do not want to have any benefits for specific branches of industry, we want to have an efficient labour market, which is too highly regulated in our mind, we want to have a more open labour market, but we also want to have social parity.

We think that worker participation is something very beneficial and I would like to take up what Mr Montezemolo said, we would like our workers to have fewer welfare costs and taxes to pay out of their salary. If you look at the social expenditure it constitutes up to 55% of their salary. But nowadays the state does have to have tax revenues to come to grips with its indebtedness but only if we have more employment in Germany, and if we have a reasonable ratio between taxation and the burden of social costs and economic efficiency. How do we achieve this as an association? We wish to be the advisers to the government but we also want to be critical advisers and we are in contact with all ministries and ministers and with the Prime Minister and the President and also with the local governments and we are very much involved

in political discussions. Last year we showed that family enterprises are really taken seriously in the country. Our voices are certainly heard.

Now, how did we overcome the crisis? We have branches that were less sensitive such as retailing, for example, but we have other branches that had a decline of 20-40%, such as the automotive industry. If there were surveys regarding the entire crisis, what is the economic situation? You might be quite surprised. I just had a survey from the second quarter which I did not bring with me but I remember that, at the moment, as of today, 80% of the family companies in Germany, if we look at their situations, are defined as satisfactory or good and 18% are sufficient and 6% are in a sort of deficient or worse situation. So the economy is quite sound and what are the prospects for the coming months regarding orders? Since the worst peak of the crisis only 20% of the companies were massively affected, which means that the German economy has learned how to live with this kind of recession and to live with a no-growth rate for one, two or even three quarters. I think it should be possible for a nation to levy taxes even when there is zero growth rate. Now, as to investment, our companies this year plan a 30% expansion on investment and 46% still have open positions, let us say, and 17% are maintaining their job levels, and 5% planning to further reduce their jobs and last year that was 14%, so you see there is a clear recovery there. The credit costs of our enterprises have only risen from 14 to 20%. For half of the enterprises the credit costs stayed the same and in 15% they even dropped, so there do not seem to be any threats on the credit.

So your questions might be, what are the present challenges? But just briefly I would like to say that there was a smaller growth in the unemployment rate than expected, and this is thanks to two effects. Firstly, the clearly greater flexibility in regulating part-time work, in that there were easier agreements with work councils and the companies, the demands were not so exigent and the government is taking on some of the social costs of these part-time workers, and this has cost the state something, clearly, but all in all I think employment has been secured and I think it has been made use of in a very accountable way, and there seems to be a recovery although there is still a challenge there. Secondly, the reason why we have fewer jobless than before is that there is a moment of respite for companies in that we have learned how to come to grips with lower turnovers and we wish to retain skilled workers at all costs, we have also had a decline in our turnover of 20% but we did not wish to dismiss any of these trained skilled workers, we wish to hold on to them and we are ready to not try to maximize the most of this particular period. Another aspect that was discussed

with the Prime Minister when we had the economic summit was a sort of common sense where we shared the same views together with the larger companies and this greatly helped to overcome this difficulty.

Now, I would like to come to the major challenge that we had to face and that maybe the whole world had to face, which is tied in with the attitude of humanity vis-à-vis the economy. The CMS carried out a representative survey which puts the following question: managers and morals. How can managers (of big stock listed companies) deal with morality in daily business? The answer was, that just 34% think managers deal in an accountable way. Another answer was that for 82% of the German public maximization of profit is the number one target of managers. Sixty-three percent of the people who were questioned say that managers do not take employment responsibility very seriously. If this is the atmosphere in a country it is very difficult to create any long-term policy for growth. This is a problem that all western governments are facing.

#### WHAT ARE THE RESULTS OF THIS SURVEY REGARDING FAMILY COMPANIES?

The picture that is portrayed of the family companies and medium-sized enterprises is very good. With TSM we asked, where would you like to be employed? Eighty-seven of those questioned said they would like to be employed in a family-owned company. There seems to be a romantic perception that you will be part of family life but obviously people do feel that where they can link responsibility and decision-making directly to an individual they see the authenticity of leadership. Even if negative decisions in dismissals are to be made, these are accepted. People know that family companies who are oriented towards innovation and competitiveness have 50% of the total employment and 80% of the trainees. No hire and fire: instead responsibility is actually experienced there.

#### LESSONS FROM THE CRISIS

The 'family company principle' consists of the fact that we do show responsibility for the company and for good products for our clients but we are also responsible for our employees. This is anchored in a long-term guarantee for the products we produce and with the assets that are invested. My company, for instance, offers a five-year guarantee, and if in that five-year

period things are not OK we extend the period for that specific feature to another five years. And if you stand for your products in that way, you know exactly what kind of business you enter into and we can draw lessons from these crises too: every company and every bank and all the other financial institutions should guarantee their products for a longer period. With this good old principle there would not have been any subprime crisis.

The second lesson for us was that those companies that were sufficiently equipped with their own equity did well during the crisis. Family companies usually are not using every opportunity for high leverage and growth, do not have much debt and proceed in a very cautious way. They appreciate their independence from capital markets and other financial institutions. Sustainability of action is a key principle.

Thank you.

# THE ROLE OF THE SOCIAL SCIENCES AND HIGHER EDUCATION IN THE CURRENT ECONOMIC CRISIS

MARY ANN GLENDON

'Why did no one see it coming?' That was the question that Queen Elizabeth posed to the experts during her visit to the London School of Economics in the summer of 2009. It was a question that had occurred to more than a few people as they struggled to deal with the economic tsunami that engulfed the world so suddenly. How is it possible that so many brilliant, well-educated men and women, so many financial experts with key positions in governments and in the private sector, did not anticipate that the world's economic and financial systems were headed for disaster?

In point of fact, warning signs had been noted by many observers, including the participants in this Academy's globalization studies.<sup>1</sup> But it took three days for a team of eminent economists to come up with a reply to the Queen's completely natural question. The answer they produced, after their triduum of cogitation, was that the main problem was that the experts had been doing 'a good job' at what they were supposed to do within the narrow confines of their separate disciplines, but they had failed to understand the risks to the system as whole.<sup>2</sup>

No doubt the tunnel vision that can arise from specialization was part of the explanation of why so many of the best and brightest failed to notice the storm clouds gathering on the economic horizon. But the fact that so many economic and financial experts, educated in the world's finest universities, were incapable of seeing serious problems in their own fields should prompt reflection on the kind of education that political and economic decision-makers are receiving in our institutions of higher learning. If Queen Eliza-

<sup>1</sup> See, especially, *Summary on Globalization*, Juan J. Llach ed. (Vatican City: Pontifical Academy of Social Sciences, 2008).

<sup>2</sup> *The Guardian*, Sunday, 26 July 2009.

beth had visited one of London's great hospitals and found it staffed with doctors and nurses who were unable to distinguish between a healthy human being and a sick person on the verge of collapse, one would wonder about what kind of training those doctors and nurses had been given.

In connection with the aim of this Plenary Session to contribute constructive ideas for 'Re-planning the Journey', it is appropriate for this Academy to consider whether there is something about our universities, or the contemporary social sciences themselves, that may have contributed to the current crisis. My reflections on that problem concern three ways in which higher education is failing to prepare young men and women adequately for the challenges posed by contemporary economic and political life. I will begin with the hyper-specialization factor mentioned by the British economists to the Queen. Next, I will consider the observation by Archbishop Celestino Migliore in a speech at the United Nations that, 'The practice of economics has long sought to remove values and morality from economic discussion, rather than seeking to integrate these concerns into creating a more effective and just financial system'.<sup>3</sup> Finally, I will turn to the rather primitive state of our knowledge about regulation.

#### SPECIALIZATION AND THE SEGMENTATION OF DISCIPLINES

Though the answer the British economists gave the Queen fell far short of a complete response, it did get at the difficulties posed by the need for specialization. Modern higher education has not dealt particularly well with the fact that no one person can possibly master all fields of human knowledge. That dilemma is hardly a new one. Already in the 1st century BC, Cicero expressed concern that the various academic disciplines were becoming so divided into parts that people were losing sight of 'the alliance and affinity that connects all the liberal arts and sciences, and even the virtues themselves'.<sup>4</sup>

In modern times, of course, the segmentation of knowledge has accelerated, along with the need for ever more specialization. How could it be otherwise? Neither the natural nor the human sciences can advance with-

<sup>3</sup> Archbishop Celestino Migliore, Address to the UN Conference on *The World Financial and Economic Crisis and its Impact on Development*, June 26, 2009.

<sup>4</sup> Cicero, *De Oratore*, 33.

out rigorous specialized knowledge. The double challenge for educators, therefore, is to find ways to enable people to form intelligent judgments about the opinions of experts, and at the same time to form experts who are capable of seeing their work in its broader context.

That need was already obvious to 19th century thinkers like Wilhelm von Humboldt, John Henry Cardinal Newman, and John Stuart Mill, all of whom took a particular interest in education. Newman argued in his classic essay on *The Idea of the University* that universities needed to develop in their students a philosophical habit of mind and the ability to trace the relationships among different parts of knowledge.<sup>5</sup> Mill, in a similar vein, wrote that, 'Men are men before they are lawyers, or physicians, or merchants or manufacturers; and if you make them capable and sensible men, they make themselves capable and sensible lawyers or physicians'.

Most universities today, however, have become so oriented toward preparing students for their future occupations that they have ceased being *uni*-versities and have become *multi*-versities – all too often run by people who are incapable of explaining what connects the parts of the curriculum or even what it means to be an educated person.<sup>6</sup>

No one, of course, can reasonably deny that our students have to be prepared to make a living. The challenge for institutions of higher education, therefore, is to equip young men and women to live in the world of necessary specialization while enabling them to keep in view the relation of the various specialties to each other and to what recent papal encyclicals call 'human ecology'.<sup>7</sup>

On that point, it would be difficult to improve on what the great theorist of rationalization and bureaucratization, Max Weber, said nearly a century ago in his famous lecture on *Science as a Vocation*. Social scientists, he admitted, must deliberately constrict their field of vision if they are to do their job well. 'A really definitive and good accomplishment today', he said, 'is always a specialized accomplishment. And whoever lacks the capacity to put on blinders, so to speak, may as well stay away from science'.<sup>8</sup> That observation

<sup>5</sup> John Henry Newman, *The Idea of a University* (Notre Dame: University of Notre Dame Press, 1982), 76-77.

<sup>6</sup> Ernest Fortin, Thomas Aquinas and the Reform of Christian Education, in *The Birth of Philosophic Christianity: Studies in Early Christian and Medieval Thought*, Brian Benestad ed. (Lanham, Md.: Rowman & Littlefield, 1996), 235, 249.

<sup>7</sup> *Centesimus Annus*, 3, 39.

<sup>8</sup> Max Weber, *Science as a Vocation*, in *The Vocation Lectures*, David Owen and Tracy Strong eds., Rodney Livingston transl. (Indianapolis: Hackett Publishing Co., 2004).

from one whose work spanned all of the social sciences obviously was not meant to be a general prescription for education. Where the university was concerned, Weber's message was that the most important job of an educator is to assist students in developing habits of clear and critical thinking. 'The most challenging pedagogical task of all', he said in the same *Science* lecture, 'is to explain scientific problems in such a way as to make them comprehensible to an untrained but receptive mind, and to enable such a person – and this is the decisive factor – to think about them independently'.

Recognizing that the work of a social scientist will inevitably stray into neighboring disciplines, Weber said that in such cases, the educator's aim should be 'to provide the expert with useful questions of the sort that he may not easily discover from his own vantage point within his own discipline'.

In other words, what future leaders and experts urgently need is the kind of training that prepares them to understand complex, mutually conditioning, systems in motion; to weigh evidence; to evaluate arguments; and to demand of a given subject the degree of precision that can reasonably be expected of it. A university fails its students and society if it fails to help students acquire the skills to interpret experience, evaluate competing claims and values, and judge whether something is true or false, fair or inequitable.

Fortunately, there are many promising models for addressing these problems through teamwork, interdisciplinary work, and improvement in general education. Still, if Weber were to examine the curricula of most modern universities, it is doubtful that he would be handing out many gold stars.

#### THE ETHOS OF THE SOCIAL SCIENCES

More difficult problems are raised by the studied avoidance in academic settings of the moral dimensions of social and economic problems. The dominant opinion in the contemporary academy holds that it is futile to search for any standards by which truth or justice or morality could be assessed. This brings us to the problematic role of the social sciences in fostering the dogmatic forms of relativism that are now pervasive in universities and in society generally.

Speaking very bluntly to the members of this Academy in 2007, Bishop J. Augustine Di Noia charged that, while the origins of that mentality are philosophical, 'the social sciences have been the principal vehicle' for the diffusion in modern western societies of reductionist accounts of human nature and relativistic approaches to moral reasoning and

norms.<sup>9</sup> Uncomfortable as that judgment may be for us social scientists to accept, it is hard to dispute. Not only economists, but lawyers, sociologists, and political scientists have been all too ready to accept faulty assumptions about human nature, morality and truth that have stunted and impoverished the study of economics, law, politics and social phenomena.<sup>10</sup>

Once these flawed approaches and attitudes took root in the academy they inevitably migrated into the general culture with serious practical consequences. They have influenced the mentalities of business people, jurists, political actors, policy makers, and educators, shaping their approaches to business, government, schooling and public programs of all sorts. They helped to legitimate or rationalize the abandonment of traditional moral norms that took rise in the 1960s. It is not unreasonable, moreover, to suppose that the social deregulation of marital and sexual behavior in the 60s and 70s reinforced the 'anything goes' mentality that profited from economic deregulation in the 80s.

The ground was thus well-prepared for the pathologies that accompanied the transition from industrial to finance capitalism that took rise in the 1980s – the gradual erosion of the trust-based ethics of producers and traders, the ravages inflicted by corporate raiders in the takeover era, and the growing irresponsibility in borrowing and lending that led to the current crisis.<sup>11</sup>

The damage extended far beyond the original site of infection. As Professor Dasgupta pointed out in his paper, 'The world's poor had no part to play in the pattern of behaviour that precipitated the financial crisis in rich countries during 2007-2008'.<sup>12</sup> Yet, as many speakers testified during the 2010 Plenary Session of the Academy, the burden has fallen heavily on developing countries.

All in all, it seems fair to say that the social sciences, along with institutions of higher education, must bear some portion of the responsibility for

<sup>9</sup> J. Augustine Di Noia, *The Encyclical Deus Caritas Est*, in *Charity and Justice in the Relations Among Peoples and Nations*, M. Glendon, J. Llach, and M. Sánchez Sorondo eds. (Vatican City: Libreria Editrice Vaticana, 2007), 12, 16-17.

<sup>10</sup> *Conceptualization of the Person in the Social Sciences*, E. Malinvaud & M. Glendon eds., Proceedings of the 11th Plenary Session of the Pontifical Academy of Social Sciences (Vatican City: Libreria Editrice Vaticana, 2006).

<sup>11</sup> See the prescient works of the under-recognized writer on economic subjects, Jane Jacobs: *Systems of Survival: A dialogue on the moral foundations of commerce and politics* (New York: Random House, 1992) and *Dark Age Ahead* (New York: Random House, 2004).

<sup>12</sup> Sir Partha Dasgupta, *Financial Crises and the World's Poor*, Paper delivered at the 16th Plenary Session of the Pontifical Academy of Social Sciences 2010.

the current economic crisis by promoting a culture of moral relativism and insisting that morality is irrelevant to the study of sociology, law, economics, and politics.

As an illustration of how faulty assumptions have migrated from the social sciences and the universities into the practices of professionals, I would cite one example from my own profession and my own country: the remarkable series of changes made in the codes governing legal ethics in the United States over the course of the twentieth century.<sup>13</sup> The first Canons of Ethics for lawyers, promulgated by the American Bar Association in 1908, stated that an attorney 'advances the honor of his profession and the best interests of his client when he renders service or gives advice tending to impress upon the client and his undertaking exact compliance with the strictest principles of moral law'. That Canon stood until 1968. Then, in the midst of the era when traditional moral restraints were being relaxed in so many ways, the terms 'honor' and 'principles of moral law' were removed, and the provision was watered down to read that 'it is often desirable for a lawyer to point out those factors which may lead to a decision that is morally just as well as legally permissible'. Reflected in the change was a growing lack of confidence that there were any objectively valid 'principles of moral law'.

Then, in 1983, all of the language of moral exhortation that had characterized previous codes of conduct was removed. Words like right, wrong, good, bad, conscience, and character were taken out, and replaced with words like prudent, proper, and permitted. The 1968 Code's mild encouragement to moral deliberation with clients was replaced by the statement that a lawyer in rendering advice to a client 'may refer not only to law but to other considerations such as moral, economic, social and political factors that may be relevant to the client's situation'. He 'may', but he need not.

In sum, these changes show a progressive adaptation of ethical norms to practice and a progressive distancing of the lawyer from the moral implications of his or her work. They also show the influence of a legal education heavily influenced for over a century by the view that law and morality are entirely separate. Nearly every American law student knows the message of Justice Oliver Wendell Holmes Jr. in the most widely cited law review article ever published in the U.S.: 'For my own part, I often doubt whether it would not be a gain if every word of moral significance could be banished from the law altogether, and other words adopted which should

<sup>13</sup> M. Glendon, *A Nation Under Lawyers* (New York: Farrar, Straus & Giroux, 1994), 78-81.

convey legal ideas uncolored by anything outside the law. We should lose the fossil records of a good deal of history and the majesty got from ethical associations, but by ridding ourselves of an unnecessary confusion we should gain very much in the clearness of our thought'.<sup>14</sup>

#### THE PREVENTION/PLANNING/PROBLEM-SOLVING DEFICIT

There was a great deal of discussion at the 2010 Plenary Session about the regulatory failures that had contributed to the economic crisis, and there were many calls for more and better regulation. As social scientists, however, we should frankly admit that our knowledge about legal regulation is not as advanced as it should be. We do not know as much as we should about what works and what does not, about indirect and unintended consequences, and about the relationships between legal norms and other modes of social regulation. We still know far less than we should about one of the most complex questions at the heart of our deliberations this year: What kinds and combinations of mechanisms, at what levels, can harness the enormous wealth-creating energies of the market so as to minimize its destructive effects and maximize its benefits?

When Pope John Paul II wrote in *Centesimus Annus* of the need to tame the explosive energies of the market, he called for a 'strong juridical framework' (CA, 42). But since law is most effective when supported by habits and attitudes, the strength of any juridical framework will depend on the state of society's culture-forming institutions – the families and the mediating institutions of civil society that are each society's seedbeds of character and competence.

As is the case with hyper-specialization, the path toward improvement in this area lies through inter-disciplinary collaboration and teamwork, plus mutual cooperation between theory and practice. The individual academic entrepreneur will not make much headway.

#### THE COUNTER-CULTURAL CHURCH

In conclusion, I offer a few reflections about the approach of Catholic thought to the problems that currently hamper higher education and the social sciences from reaching their full potential. It is heartening to note the

<sup>14</sup> Oliver Wendell Holmes Jr., *The Path of the Law*, 10 *Harvard Law Review* 457 (1895).

strong emphasis on the need for interdisciplinary dialogue in the *Compendium of the Social Doctrine of the Church* published by the Pontifical Council for Justice and Peace in 2004. Stressing the importance of dialogue between the Church's social teaching and the various disciplines concerned with man, the *Compendium* notes that, 'In this regard, the foundation of the Pontifical Academy of Social Sciences is significant'.<sup>15</sup>

In a passage that is reminiscent of Cardinal Newman, the *Compendium* places special emphasis on the importance of philosophy to the social sciences: 'This contribution has already been seen in the appeal to human nature as a source and to reason as the cognitive path to faith itself. By means of reason, the Church's social doctrine espouses philosophy in its own internal logic, in other words, in the argumentation that is proper to it'.<sup>16</sup>

Finally, with regard to the relativism reigning in so many sectors of the academy and in the general society, it is fair to say that the Catholic Church has emerged as a major counter-cultural force. It has done so simply by continuing to teach that certain moral truths are built into the world and are discoverable through human reason – through the never-ending processes of reasoned reflection on experience. In the parts of *Caritas in Veritate* that are directly addressed to morality and the social sciences, Pope Benedict XVI says that, 'moral evaluation and scientific research must go hand in hand, and...charity must animate them in a harmonious interdisciplinary whole' (31). He goes on to warn that, 'The excessive segmentation of knowledge, the rejection of metaphysics by the human sciences, the difficulties encountered by the dialogue between science and theology are damaging not only to the development of knowledge, but also the development of people, because these things make it harder to see the integral good of man in its various dimensions' (31). The market, he pointed out, does not contain within itself the means to correct for its distortions. Even to fulfill its properly economic functions, the market 'must draw its moral energies from other sources' (35-39).

During the current crisis, the Holy Father expanded upon those observations. In his annual address to Holy See diplomats in 2010, he noted that, 'Twenty years ago, after the fall of the Berlin wall and the collapse of the materialistic and atheistic regimes which had for several decades dominated part of this continent, it was easy to assess the great harm which an eco-

<sup>15</sup> Pontifical Council for Justice and Peace, *Compendium of the Social Doctrine of the Church* (Libreria Editrice Vaticana, 2004), No. 76.

<sup>16</sup> *Id.* No. 77.

conomic system lacking any reference to the truth about man had done'.<sup>17</sup> In an interview en route to Prague, he commented on what happens when *market* economies become unhinged from 'the truth about man'.<sup>18</sup> 'It is clear today', he said, 'that ethics is not something outside of the economy, which could work mechanically on its own, but is an inner principle of the economy, which does not work if it does not take into account the human values of solidarity of reciprocal responsibilities, if it does not integrate ethics into the construction of the economy itself: This is the great challenge of this moment'.

It is hard to see how our societies can meet what Pope Benedict calls 'the great challenge of this moment' without some changes in the academic institutions where increasingly narrow specialization and the conscious rejection of moral reasoning have merged – to the great detriment of society. But our skeptical colleagues will certainly ask, as Max Weber and others did in the preceding century: How can one speak about truth or morality in the disenchanted modern world?

Pope Benedict offered a strikingly post-modern response to that sort of question in the address he had hoped to present at *La Sapienza* two years ago (if only that multi-university had been open-minded enough to receive him). Anticipating the usual questions about how one can know what is true, or reasonable, or just, he wrote that the quest for truth is one 'that always demands strenuous new efforts, and that is never posed and resolved definitively. Thus at this point, not even I can properly offer an answer, but rather an invitation to remain on the journey...on the journey with the great ones who throughout history have struggled and sought with their responses and their restlessness for the truth which continually beckons from beyond any individual answers'.<sup>19</sup> As for the supposed contradiction between Jerusalem and Athens – between theology and philosophy – the Pope took a stand directly opposite to that of his fellow Münchener, Weber, who would have banished theology to the hinterlands. 'Theology and philosophy', Pope Benedict said, are 'a peculiar pair of twins, neither of which can be completely separated from the other, while each must preserve its own task and its own identity'.

<sup>17</sup> Pope Benedict XVI, Address to the Holy See Diplomatic Corps, January 11, 2010.

<sup>18</sup> Pope Benedict XVI, interview en route to Prague, Sept 26, 2009.

<sup>19</sup> Pope Benedict XVI, Address for La Sapienza University, January 17, 2008.

### WHAT HAS RELIGION GOT TO DO WITH ECONOMICS?

I now come to a point that is rarely discussed in the contemporary university: the relation of Biblical religion to the problems we have been discussing. While I was preparing these remarks, I came across a report of a speech given earlier this year by Cardinal George Pell of Sydney, Australia.<sup>20</sup> It is so pertinent to the subject of the Academy's 2010 Plenary Session that I would like to quote some passages from it.

The Oxford-educated Cardinal began his talk by noting that social scientists in China have become concerned about a paradox that several of the participants in this Plenary Session have mentioned: The market economy, despite its well-known advantages, does not encourage, and in fact may discourage, the qualities of trustworthiness and respect for others that it requires in order to remain healthy. On this point, a number of our speakers emphasized the trust-deficit. Others referenced the thesis of Daniel Bell that the very success of capitalism, which depends on delayed gratification to foster saving and investment, has eroded capitalism's moral foundations by fostering a culture of immediate gratification.<sup>21</sup> Also relevant is the work of Christopher Lasch on the ways that market values of efficiency and productivity have penetrated and negatively affected family relations.<sup>22</sup>

To gain a better understanding of how market economies work, some Chinese researchers began studying the economic systems of the West. One of these researchers, according to Cardinal Pell, told a group of visitors to the Chinese Academy of Sciences in 2002 that he and his colleagues had concluded that the most important factor contributing to the health of western market economies had been 'the Christian moral foundation of social and cultural life'. Sometimes, Cardinal Pell commented, it takes an outsider 'to see what is painfully obvious, especially if the truth or insight is unpalatable and systematically avoided by many in the commentariat'. Meanwhile, he added, 'The consequences of forgetting God have been significant for morality, human dignity and society in the West'.

The remedy, in Cardinal Pell's view, is this: 'We need to introduce our children to Western civilization through the teaching of philosophy, histo-

<sup>20</sup> George Cardinal Pell, *The Heritage of Western Civilization*, March 25, 2010.

<sup>21</sup> Daniel Bell, *The Cultural Contradictions of Capitalism*, 2nd ed. (New York: Basic Books, 1996).

<sup>22</sup> Christopher Lasch, *Haven in a Heartless World: The Family Besieged* (New York: Basic Books, 1979).

ry and literature, in solid rather than debased forms; and edge them towards considering the big questions: is there truth? What is goodness?... We need to re-present God and the insights about how we should live which come from recognizing our shared human nature. Christians need to challenge intellectually the many agnostics of good will to face up to the absence of alternatives’.

#### ‘RE-PLANNING THE JOURNEY’

It only remains for me to say what is obvious. By focussing my comments on the role of higher education and the social sciences in the current crisis, I do not mean to under-rate the importance of early education, family life, or other elements of civil society. I have emphasized the role of the universities and the social sciences because problems in these areas pose a special challenge for the Church’s social teachings and for her intellectual apostolate. And as such they are of special concern to this Academy.

As Pope Benedict XVI pointed out in *Caritas in Veritate*, Catholic social doctrine has always had ‘an important interdisciplinary dimension’ (31). The Church’s social doctrine, he wrote, is ‘open to the truth from whichever branch of knowledge it comes’; it assembles what it learns ‘into a unity...and mediates it within the constantly changing life-patterns of the society of peoples and nations’ (9). In fact, it was precisely to assist in that mission that the Pontifical Academy of Social Sciences was created.<sup>23</sup> And it is precisely for this reason that our Academy has a special responsibility to ‘foster the interaction of the different levels of human knowledge in order to promote the authentic development of peoples’ (30).

I believe we can take heart, therefore, from what we have heard at this meeting so ably organized by Professor José Raga. For our speakers have enabled us to see that the current economic crisis has opened up opportunities to think and speak about morality and markets in new ways. The crisis has lent new urgency to the search for juridical measures that can discipline the creative energies of the market without destroying the system that has lifted so many men and women out of poverty. It has stimulated discussion of how to re-connect the market with the cultural foundations

<sup>23</sup> John Paul II, *Motu Proprio* establishing the Pontifical Academy of Social Sciences, January 1, 1994.

without which it cannot function. It has prompted us social scientists to ask long neglected questions: What has been the effect of the market on culture and character and family life? What has been the effect of culture and character on the market? And what Professor Dasgupta has called 'the deepest question' of all: 'How do grace and decency establish themselves among wide and disparate groups of people?'<sup>24</sup>

<sup>24</sup> Sir Partha S. Dasgupta, *Financial Crises and the World's Poor*, pp. 198-220.

## CONCLUSIONS AND GENERAL DISCUSSION

## CONCLUSIONS OF THE XVI PLENARY SESSION

JOSÉ T. RAGA

The production of a true 'conclusions' document with all the profundity suggested by the term is a task little short of impossible. The definitive text would necessarily omit aspects of enormous significance that have been studied with the great rigour that befits the activity of the Academy, but which elude the synthesis expected of a few final words to conclude the contributions of the speakers and commentators throughout the XVI Plenary Session of the Pontifical Academy of Social Sciences.

It is a moment, therefore, to express gratitude to all for the effort dispensed in the entrusted tasks and also to offer congratulations on the successful manner in which they have been carried out. I believe, and it is a personal opinion, that the objectives set by the Council of the Academy and approved by the Assembly in the final session one year ago have been achieved with the dignity to be demanded of a pontifical institution such as the one to which we belong, an institution in which there is confluence of the different fields of knowledge of the social sciences, with the results of its debates and meetings manifested in a synthesis and integration of knowledge in the service of man; the same integration described by John Paul II as the primary objective of university activity and of the University itself. '*Integration of knowledge* is a process, one which will always remain incomplete; moreover, the explosion of knowledge in recent decades, together with the rigid compartmentalization of knowledge within individual academic disciplines, makes the task increasingly difficult... It is necessary to work towards a *higher synthesis* of knowledge, in which alone lies the possibility of satisfying that thirst for truth which is profoundly inscribed on the heart of the human person'.<sup>1</sup>

<sup>1</sup> John Paul II, Apostolic Constitution on Catholic Universities *Ex Corde Ecclesiae*, Rome 15.08.1990, n. 16.

Theologians and moralists, sociologists and political scientists, lawyers and economists from all over the world come together with the common objective of placing their knowledge at the service of the community, at the service of the human family, in the unselfish quest for scientific truth which, as such, coincides with the truth of man, which lends it meaning. It is this atmosphere of scientific diversity and commitment to the common task which confers greatness on our mission to provide, within our limitations, a contribution to the Church and a service to humanity.

It has been possible to fulfil the programme designed at the outset with reasonable magnanimity. It is true that, for reasons of force majeure, some participants initially due to attend were unable to do so and we have been deprived of their valuable contributions. In all cases, those involved regretted that they could not share in the different sessions of this XVI Plenary Session. Such an occurrence is unavoidable when commitments are entered into more than six months in advance in a world presided over by uncertainty and risk.

All the papers, I would say without exception, and indeed it is a pleasure to be in a position to make such a statement, take into account not only the technical features of the crisis in respect of the scientific fields of the presenters, but also the background which made such features possible or inevitable, in addition to the consequences of the economic and financial situation for people, families and for the community as a whole. This shows the commitment of all the presenters to go beyond the technical analysis of means and ends in order to deal with the ultimate objective of all our considerations: the human person.

Nonetheless, and for purely methodological purposes, I will venture to organise the synthesis of the conclusions by grouping the most significant contributions into four areas, whose order is not random: a) Economic aspects; b) Moral considerations; c) Social framework; d) Education fundamentals.

#### A) AN ECONOMIC VISION OF THE CRISIS

It is evident that economic activity is one aspect of human activity and for this reason is conditioned by the criteria, assessments and objectives of the person who, on a daily basis, makes decisions which cause economic effects both for himself and for society as a whole. Any diagnosis, therefore, must begin with a knowledge of the values scale applied by the subject to

his own activity, that scale which constitutes the itinerary in which his behaviour is circumscribed. We must not forget the words of Benedict XVI: ‘...every economic decision has a moral consequence...’<sup>2</sup> Therefore, the economic analysis of the crisis has also concentrated on the consideration of man and the values present in his behaviour.

It is evident that man today lives immersed in a materialism that prevents him from seeing the horizon of transcendence that is an integral part of him, to the point where a 3% fall in the gross domestic product can cause upheaval, and not only economic upheaval, in the life of the subjects. The short term has become the sole acceptable dimension, that is to say, an immediate gain prevails over an uncertain future penalty, because the discount rate to estimate the present value of both is extraordinarily high. The quantitative has replaced the qualitative and any frivolous or simply material element that can be measured, weighted and valued in monetary terms, cancels any consideration or reference of a spiritual nature, those references that are to be found deep in the heart of man. It is, therefore, not surprising that the financial economy has acquired a central role, as opposed to any consideration of the real economy and both predominate clearly over the spiritual expressions and strictly human values which should preside over relations of all types in society.

A predominance of financial aspects is consolidated by the anxiety for temporary things. Profit, legitimate in principle, is all the more desired in accordance with the brevity of the period required for its attainment. Speculative activities, so deep-rooted in these historic times for the global world, provide a good example of the old financial principle of *quick in, quick out*. It is an activity type that solely pursues the attainment of a return, without the creation of any commitment or will for permanence with respect to the community to which we belong.

Hence, the subject, conceived as lord of the Creation, relinquishes his very being to become just one more link in the chain of economic activity. At the same time as the worker, the producer, the consumer, the saver, the investor, etc. appears on the scenario, the man of work, the man of production, the subject of consumption, etc. disappears. It is this abstraction of the human condition that ultimately makes man a slave of the economy, the server of a principle that does not constitute the essence of his very being, but rather, external to it, is no more than a random aspect and as such is

<sup>2</sup> Benedict XVI, Encyclical letter *Caritas in Veritate*, Rome 29.06.2009, n. 37.

ephemeral in its permanence as a good of man: we speak of the submission to a new commandment that proposes the ethics of efficiency or, if you wish, of profit, as the governing principle of human activity. So it is that any means is valid if it finally drives to the desired end. Deceit, fraud, coercion are useful instruments, when one turns one's back on morals, to reach the established goal: the highest benefit and the biggest power.

With good reason there has been distinction, throughout the Plenary Session, between the important role of economic activity carried out by the businessman who is aware of his life project, a project that tends towards God, and the other type of activity that only takes the present into account, without any other consideration that might be deduced as a worthy commitment, in accordance with the dignity of the human person. With fortunate terminology, distinction has been made between the *sine specie aeternitatis* businessman, for whom the present moment in time covers the entire existing dimension and for whom other references are of no use, and the *sub specie aeternitatis* businessman, whose acts are placed within an established process for the purposes of fulfilling the will of God and in order to participate in the achievement of the common good.

When these references disappear, man is inclined towards the immediate satisfaction of his wishes and towards the exploitation of all his possibilities. An indication of this, according to what has been said, is the extraordinary vulnerability of the financial sector, in terms of sustaining its own activity, when said activity takes place in a framework of lax regulation or indeed corruption with little or no penalty. The shortage of references in economic activity leads to a lack of consideration of the adverse effects of conducts and a still greater failure to consider those who suffer these effects. Let us reflect, in this sense, on the complete lack of consideration for the effects that might be felt in third countries as a result of the distribution through the financial markets of the toxic assets issued in one country and rapidly transmitted to other countries and continents.

Despite this, it seems to cause some ill-feeling or envy to see countries such as China and India, along with a good number of developing countries, clearly improving their economic level, while the developed countries see their growth possibilities deteriorate, with rates that are even negative, thereby imposing restrictions on the level of well being that they have been enjoying. What is more, the optimism that should arise from the presence of such countries in the international forums of economic decision-making (such as the G-20) is overshadowed by doubts about their intentions or by their calls for justice in economic and foreign trade relations worldwide,

that make the rich countries concerned, at the same time as they are concerned about the infection capacity of these to those.

Seven reasons have been presented for the probability of that infection: a) the difficulties of the poor countries to access the external market, as much for financing as for insurance; b) export revenues will diminish as a consequence of the decrease in the external demand for their products, besides the reduction in the prices of the same; c) the value of foreign securities diminishes, as a consequence of the decrease in their yields; d) reduction in foreign investments; e) reduction in external aid; f) reduction in external remittances; and g) reduction in tourism.

The crisis, which for some started in the financial sector and was then transmitted to the real sector and for others occurred in the reverse sequence – first in the real sector, which did not see the need to adjust its imbalances because it had at its disposal the financial resources required to maintain them – has highlighted all these insufficiencies and all these irresponsible conducts that have destroyed what little had been built, generating problems even for those responsible for such behaviour.

Therefore, in this Plenary Session which has come to an end, there has been a call for more efficient and appropriate regulation of the financial markets, in the belief that it is in these markets that the vulnerability due to the conduct previously referred to, occurs with the most frequency and scope. This regulation should pay sufficient attention to: the demands that financial entities have sufficient capital if they are to be permitted to operate in the market; the improvement in the covering of risk in credit transactions; restricting the leverage rate of financial operations; the development of liquidity requisites that provide security and availability of financing resources: the moderation of the rewards – *bonuses* – received by executives of financial entities and companies in general, which have been scandalous in a time of crisis; the increasing transparency in the activities of Rating Agencies, etc.

Now then, although these measures are necessary, they are not sufficient. When we speak of financing and mainly of difficulties or disturbances in the financial market, we should not reduce the analysis to that which corresponds to the private sector of the economy, either households or enterprises; the public sector also plays, or can play, a significant role in this type of problems. When it happens, it is necessary to pay special attention to the budgetary equilibrium as the basic goal and, certainly, to eliminate excessive deficit by reducing public expenses, despite how unpopular that is and, in their case, to increase the taxes lightly; those taxes that less

distort the market. Next to it, another measure, which in this case corresponds to the real sector, is the one to increase the productivity of public resources with the reduction of wages, and, in all cases, to reform the labour market, introducing greater flexibility to adjust it automatically to the requirements of the production.

#### B) MORAL FUNDAMENTS OF THE ABOVE CONSIDERATIONS ON THE CRISIS

For the Church, the economy is not the centre of human activity and certainly does not constitute the reference which should inform the behaviour of men. In the words of John Paul II, ‘...The economy in fact is only one aspect and one dimension of the whole of human activity. If economic life is absolutized, if the production and consumption of goods become the centre of social life and society’s only value, not subject to any other value, the reason is to be found not so much in the economic system itself as in the fact that the entire socio-cultural system, by ignoring the ethical and religious dimension, has been weakened, and ends by limiting itself to the production of goods and services alone’.<sup>3</sup>

Man is created as a free and responsible being who is called to gift. ‘The human being is made for gift, which expresses and makes present his transcendent dimension. Sometimes modern man is wrongly convinced that he is the sole author of himself, his life and society. This is a presumption that follows from being selfishly closed in upon himself, and it is a consequence...of *original sin*... “Ignorance of the fact that man has a wounded nature inclined to evil gives rise to serious errors in the areas of education, politics, social action and morals”’.<sup>4</sup>

It is precisely for this reason that laws are required to penalise actions far removed from the good of man and society. Laws are demanded to penalise corruption, because this shows the triumph of evil over good, it shows the abandonment of the human person with respect to his destiny, inclining himself towards the call of sin, to the offence of God and of humanity. Laws in which the punishment demonstrates the perversion of the behaviour described and the harm it produces for the author and society as a whole. But, in addition, there must be faithful fulfilment of the expectation of society that such laws be applied with rigour and justice.

<sup>3</sup> John Paul II, Encyclical letter *Centesimus Annus*, Rome, 01.05.1991, n. 39.

<sup>4</sup> Benedict XVI, Encyclical letter *Caritas in Veritate*, Rome 29.06.2009, n. 34.

It is necessary to distinguish in these norms two different elaboration procedures: those that come from above (norms of general character, usually of international organisms) and those that proceed from below (those that are established for specific application in a certain country) and that complement or develop the previous ones. It is necessary to recognize that the former, those that fix international standards, have demonstrated a very low effectiveness, which doesn't authorize to think that the positive experiences at the national level can be translated to the international scale, since in the latter, the conflicts of interest among nations are abundant and common.

It cannot be forgotten that man is a social being by nature and therefore sociability is an inherent part of him, through the will of God. 'It is not right that the man should be alone...'<sup>5</sup> we read in Genesis. This is why man is born, lives and dies in society; moreover, he perfects himself in society when his generous and fraternal commitment tends towards improving the condition of the members of the community. Person, family and society, in that order, are what give realism to human sociability. Furthermore, a large number of the necessities felt by man can only be satisfied in the family environment or in that of the community to which he belongs. Let us think of companionship, comprehension, the testimony of love, the desire to generate life, to attend to education, etc.

It is true that the market has the capacity to offer a route for the satisfaction of the material needs of people, and to do so efficiently, but it cannot even achieve this efficiently without an ethical reference, a reference within which the conservation of resources is of fundamental importance. It cannot be forgotten that the earth and all that exists on it – that is to say, what we know as natural resources today – has been given to man, to all mankind, and to all men. It is therefore not in accordance with ethical responsibility to abuse resources, to capture them, and for a few to waste resources to which many others lack access, because in the natural order, there is no preferential right to such activity. And when we speak of all men, we refer both to the present generation and future generations.

We can now see that, even when we speak of material needs, the market, without moral considerations, is capable of causing damage that is difficult or even impossible to repair. It is impossible to repair when, due to lack of means, a person is deprived of sustenance, or constrained in his promotion and his complete development. This represents an attack on the

<sup>5</sup> Genesis 2:18, *New Jerusalem Bible*.

dignity of the human person, the defence and promotion of which is the obligation of all. The structure of the market, in synthesis, is based on exchange or barter. Arising from that structure, many people and families will be deprived of what is necessary to live with dignity; people who cannot offer anything material as an instrument of exchange.

But along with these situations, which in themselves can cause anguish for people, as subjects who aim to satisfy material needs, there is the wide range of spiritual needs or at least immaterial needs to which the market cannot offer a route to guarantee their satisfaction. In these needs, gratuity rather than exchange shines bright. To be perceived in them is the fraternity that invades the affectionate relationship, without equivalence in respect of compensation. Therefore, the market is no more than an instrument which is correct for a series of objectives as long as certain circumstances prevail. When these circumstances do not exist, or when the objectives exceed the contractual relationship specified for the exchange operation, with rights and obligation of the parties who enter into such contract, the market becomes something sterile; a sterility that is only overcome when we open the possibility of considering ethical or moral elements, which thus qualify the behaviour of those who operate in it.

To reduce man to an animate being with needs of a purely material nature, without social responsibility in the satisfying of such needs, is tantamount to dispossessing the person of his true being – material body and spiritual soul –. In the words of St Augustine, '*Anima rationalis habens corpus, non facit duas personas sed unum hominem*';<sup>6</sup> it is for this reason that human needs encompass both the spiritual order and the material order. An economic crisis will be all the deeper and will cause proportionately greater despair depending on the degree to which we reduce man's needs to the material sphere and entrust their satisfaction to the automatism of a market that is inert to the values that should inform human behaviour and devoted to a mechanism in which man lacks the space necessary for sustenance.

Does the solution lie in rejecting the market and substituting it with state planning? If we have said that the natural order was person – family – society, it must be added that the State would come after society. The priority is very clear in the words of Leo XIII: 'There is no need to bring in the

<sup>6</sup> St. Augustine, *In Johannis Evangelium*, XIX,5. In the same sense *De quantitate animae* XIII,22; and *De moribus Ecclesia* I,27,52.

State. Man precedes the State, and possesses, prior to the formation of any State, the right of providing for the substance of his body'.<sup>7</sup>

C) THE SOCIAL FRAMEWORK, RESULT OF AND CONSTRAINT ON HUMAN BEHAVIOUR

In effect, faced with the danger of individualism, and more so the empire of individualism, the solution is not collectivism but rather the aperture to fraternity. This is where man enjoys his human condition, where he opens himself to gratuity and feels himself the protagonist in the act of promoting the common good.

From individualism, it is conceptually impossible to configure a political or social organisation, insofar as such organisation is justified by its capacity to attend to those needs – material and immaterial – that the singular person would find impossible to attend to by his action. The isolation of individualism is contrary to commitment and solidarity. Indeed, solidarity is only conceivable where there exists interdependence between brothers, as children of the same father. John Paul II stated: 'solidarity...is not a feeling of vague compassion or shallow distress at the misfortunes of so many people, both near and far. On the contrary, it is a firm and persevering determination to commit oneself to the common good; that is to say to the good of all and of each individual, because we are all really responsible for all'.<sup>8</sup>

A civil society wishing to be strong can only be so with bonds of interdependence that subordinate, without coercion, private and exclusive interest, the pursuit of isolated personal benefit, to the general interest, or better still, to the common good, as the good of each and every member of the community. This common good is configured clearly in the Encyclical letter *Caritas in veritate* as the comprehensive development of man. Benedict XVI said that, 'When animated by charity, commitment to the common good has greater worth than a merely secular and political stand would have. Like all commitment to justice, it has a place within the testimony of divine charity that paves the way for eternity... In an increasingly globalized society, the common good and the effort to obtain it cannot fail to assume the dimensions of the whole human family, that is to say, the community of peoples and nations, in such a way as to shape the *earthly city* in unity and

<sup>7</sup> Leo XIII, Encyclical letter *Rerum Novarum*, Rome 15.05.1891, n. 7.

<sup>8</sup> John Paul II, Encyclical letter *Sollicitudo Rei Socialis*, Rome 30.12.1987, n. 38.

peace, rendering it to some degree an anticipation and a prefiguration of the undivided *city of God*.<sup>9</sup>

It is this concept that embraces the human family in its entirety which can provide the solution to the lack of trust which seems to be a cornerstone of the current crisis. This lack of confidence cannot be solved in the individual sphere, because confidence exists in somebody, that is to say, that mutuality is necessary. Confidence in oneself cannot be considered a social value. It cannot be taken as a value for co-existence, since a person in himself does not constitute a community and does not configure sociability; for this, a social group is needed, however small it might be. We should not make a mistake in confusing trust with interest. Both can pertain to related people, but the causes that determine this relationship are very different.

It is not necessary to resort to abstract models of society. Society is configured by life in society, in that *modus vivendi* in which the relationship between the people making up the social nucleus is encapsulated. This is the seed on which a civil society is based, capable of facing, with the bonds of interdependence, a crisis which has hit the entire human family, not only economically but also in human terms. A human family made up of singular persons and families who today feel distressed in the face of such crisis.

#### D) EDUCATION, A SEED TO GERMINATE

We speak continually of education, the educational process, the importance of education for a harmonious and responsible society. And, as educators, we underline the nobility of the teacher's function as a qualified task in programmed education. However, faced with the turbulences of life, whether these are of an economic nature – such as those we contemplate herein – or of a social type, it seems that man finds himself without a response, without the instruments to confront adversity.

The response in the face of the crisis is, in an infinite number of cases, depression and discouragement, as opposed to the fight which would lead to decisive action designed to reduce its effects. Therefore, in the light of the current situation, it is interesting to ask ourselves: What is the education that we are providing to young people? What is the real objective of the edu-

<sup>9</sup> Benedict XVI, Encyclical letter *Caritas in Veritate*, Rome 29.06.2009, n. 7.

cational process? Will material elements and the short term continue to be the goals of educational action?

If we enter even superficially into the process, it will stand out with particular clarity, and even more so in the university period, that the profession is the spotlight that illuminates the educational process. That is to say, in all probability, we are not training persons, but rather professionals, and these we shape free of commitment to the society in which they will exercise their function. It cannot surprise, therefore, that in the current crisis, there has been an abundance of cheating and fraud and excessive regard for the short-term coupled with disdain for that which belongs to the long-term. What is more, the crisis has shown us people who, like automatons, have pursued their professional objectives – usually quantified in monetary terms – and pursued them with complete disregard for the costs that such objectives represent for the community in general and people in particular.

Their behaviour has been similar to that of the isolated mercenary who, thinking of himself, lacks any consideration for others. His objective has a very short-term dimension, and consequently, relations in the environment, even the most restricted environment, do not have much sense. The concept of community or that of society is absent. Their behaviour is not subject to moral considerations because theirs is a morality specially designed for themselves. An individual morality in which the other does not exist and will never exist. His or her presence is purely transitory and transient

Interdependence has no meaning, and affection for persons and institutions lacks realism. The profession is lived aggressively and is based on the position of importance that may be achieved through notable performance and in the shortest possible period. If this is the reality contemplated in the professional world, it is necessary to determine whether these should be the objectives of education, if education is aimed at a market in which the desires of demanders must be satisfied, irrespective of what those desires might be.

In this scenario, knowledge and the enjoyment and discovery of knowledge do not appear to hold a preeminent place. The fact is that knowledge as an input in the formation of personality is not even considered to be appropriate. Knowledge and that which needs to be known is defined as what might be considered useful for the practice of the professional activity to which the demander of education, the student, is looking for.

In fact, educational programmes are gradually eliminating the most formative disciplines and substituting them for those of a more technical nature, so that at the end of the process, the student – now a graduate – has

at his disposal a toolbox that enables him to enter the labour market and find the desired profession with the expected remuneration – the latter being of greater importance than the former –. Hence, the term most employed in educational policy today is ‘employability’. Everything revolves around the possibility of employment.

Hence, there is also an attempt today to reduce the period spent studying, for the purposes of beginning the search for employment as soon as possible. Employment seekers lack the basics of who they are and what their purpose is, of their debt to society for the opportunities it has afforded them and, in consequence, what society expects from them.

If knowledge is of no significance, even less so are humanist reflections and teachings. What space is occupied today by philosophy, metaphysics, and theology, in study programmes? Do we expect honesty, truth, tranquillity, attention to the particular conditions of each...? If what we sow is materialism, if predominance is granted to utilitarian schemes as opposed to greatness of heart and commitment to the good of others, we cannot expect to harvest anything other than what we have contemplated with horror in the form of the current economic crisis.

It is of course true that laws can contribute. After all, they have a great pedagogical effect by demonstrating conducts in accordance with an honest and harmonious society, and penalising attitudes which serve to contravene that social project. After all, the criminal bereft of any moral feature does consider the cost-benefit relationship of his criminal behaviour. What is the benefit expected from immoral conduct and what risk is taken if one is penalised by the courts?

Exemplariness is also an educational channel, though it has to be acknowledged that it is the last resort of education. To move through the jungle of life, it is necessary to know its paths, to know the equipment required for the journey, to calculate the strength with which one sets out and to understand that any traveller could be of great help at any time of need. That is to say that we need open-minded people, with the capacity to integrate into working teams and with ability for reflection, and we do not need self-sufficient people, because all of us have great shortcomings. On the contrary, we aim for people who are convinced that the world today is so complex that only with the cooperation of others will we achieve the fruit of our labours; moreover, that only with a joint vision of the problem – of any problem – will it be possible to find a solution, through the cooperative interaction of those who commit to it.

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The contrary is to have to listen to the response received by Queen Elizabeth II of England when, on visiting the London School of Economics, she asked about the crisis, its possible forecast and the instruments to reduce its effects. The compartmentalisation of knowledge cannot produce anything other than dysfunctions in the activity entrusted to us.

## TABLES

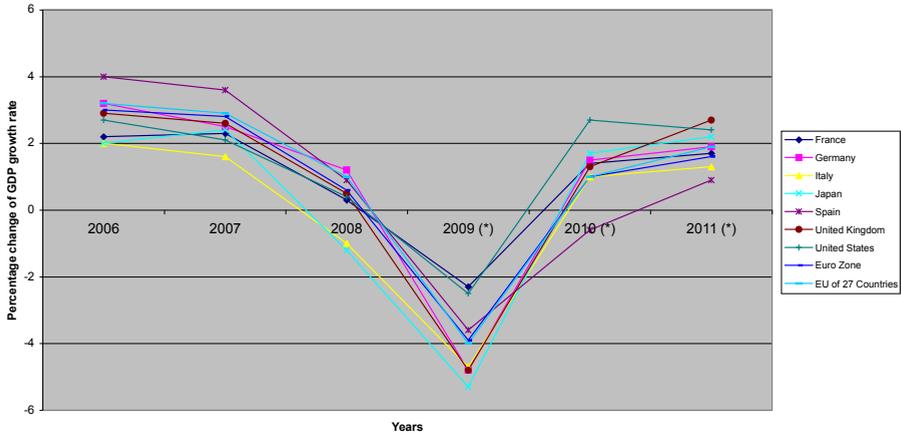


Figure 1. Total external debt at the end of period (As percentage of the GDP).

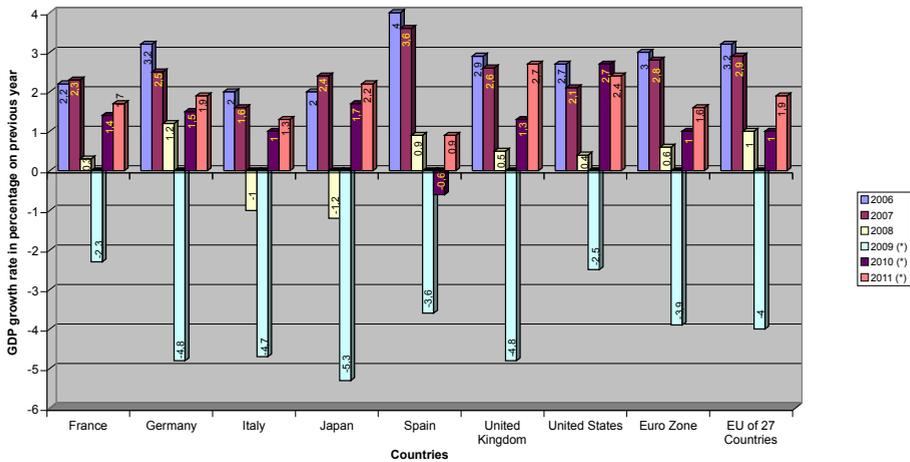


Figure 2. Real GDP growth rate (Percentage change on previous year).

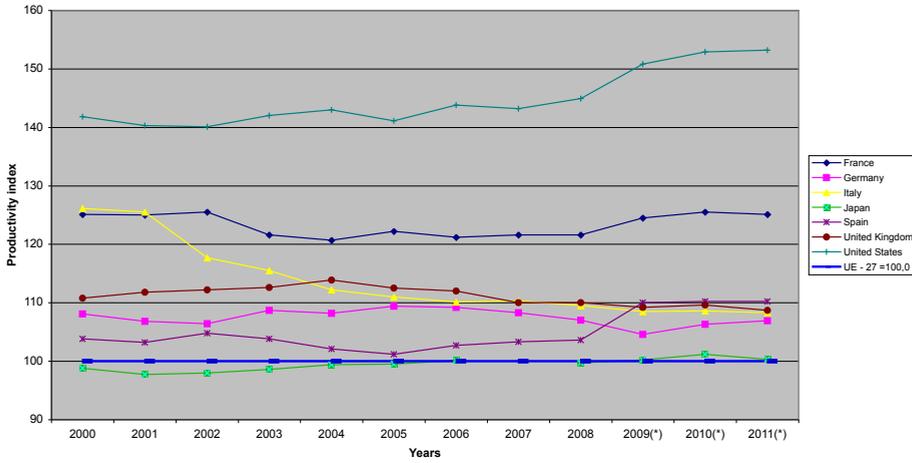


Figure 3. Productivity index referred to EU-27=100.

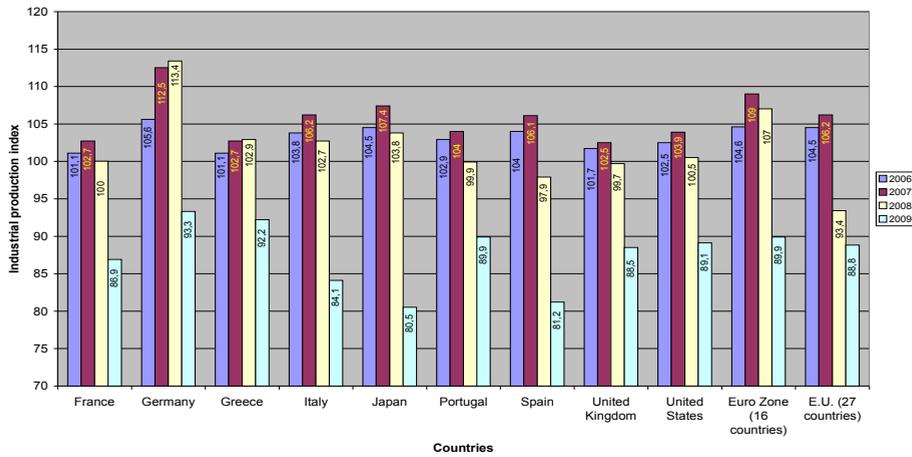


Figure 4. Industrial production index [2005=100] (Excluding construction).

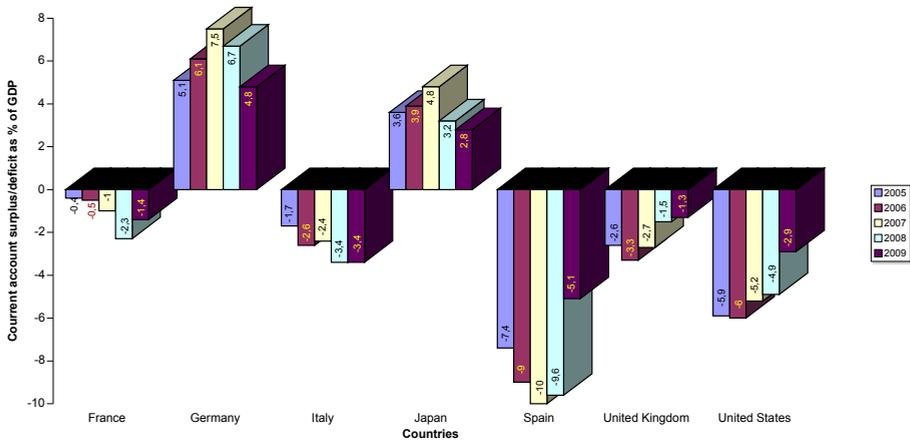


Figure 5. Current account balance (In percentage of GDP).

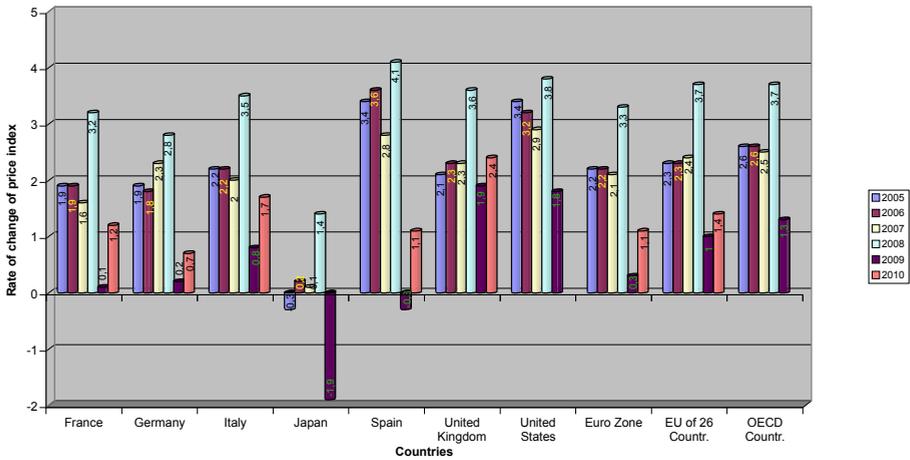


Figure 6. Harmonized consumer price index (Rate of change on previous year).

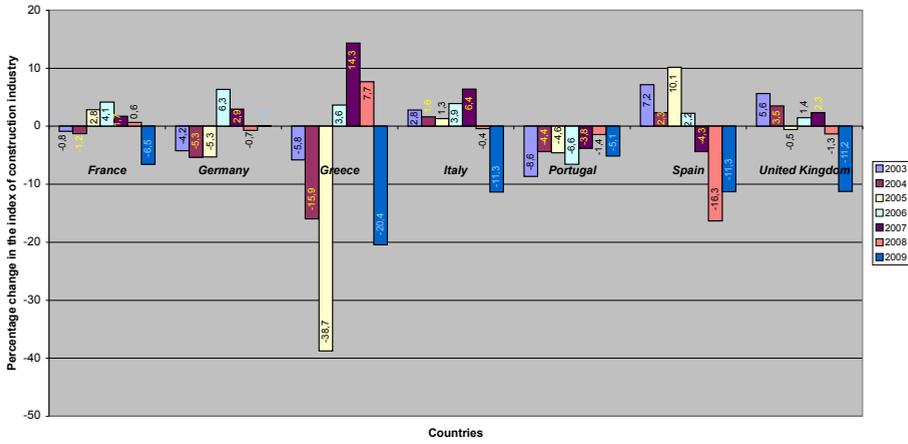


Figure 7. Index of construction industry (Percentage change on previous year).

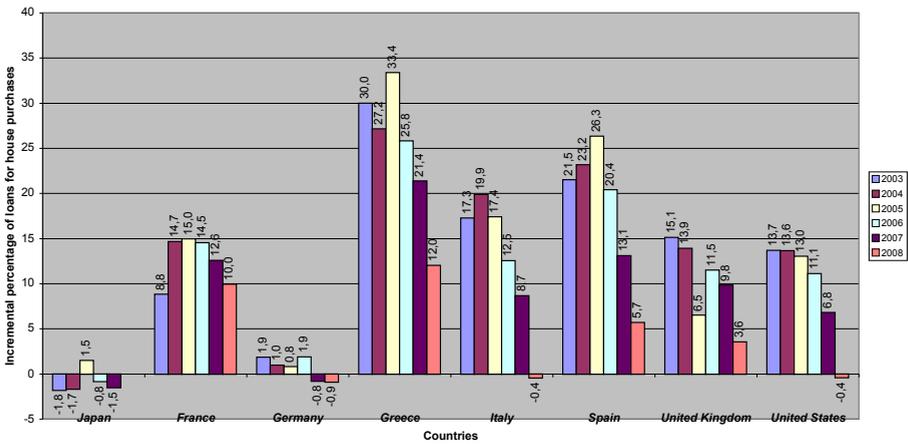


Figure 8. House purchase loans of households (Incremental percentage on previous year).

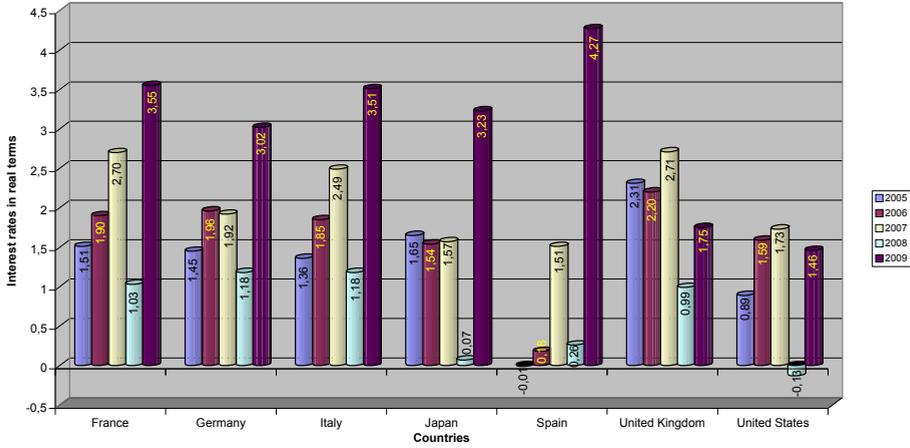


Figure 9. Interest rates in real terms (Nominal interest rate minus inflation rate).

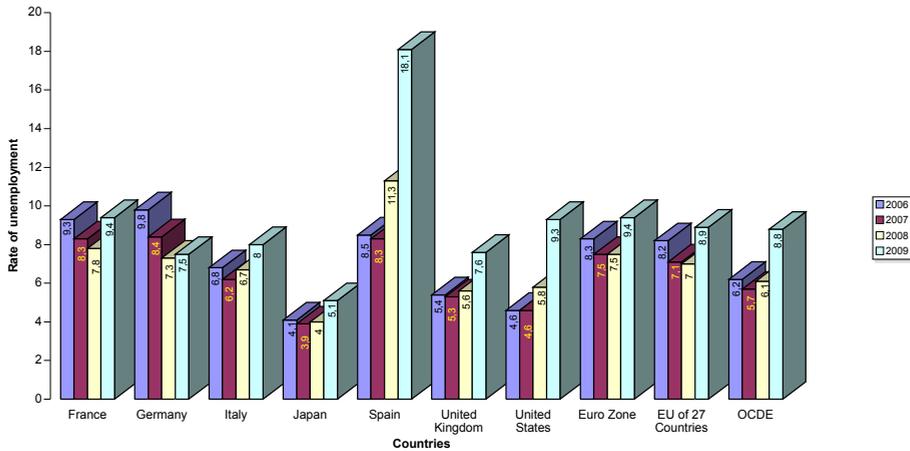


Figure 10. Rate of unemployment (In percentage on active population).

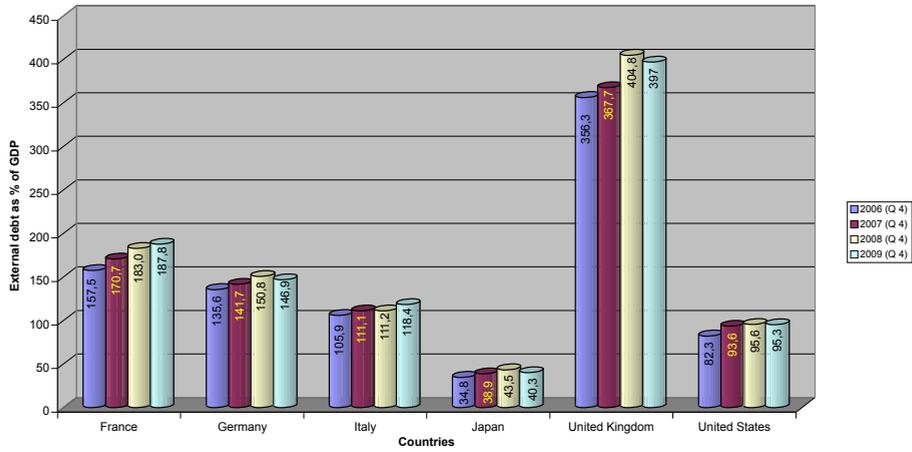


Figure 11. Total external debt at the end of period (As percentage of the GDP).

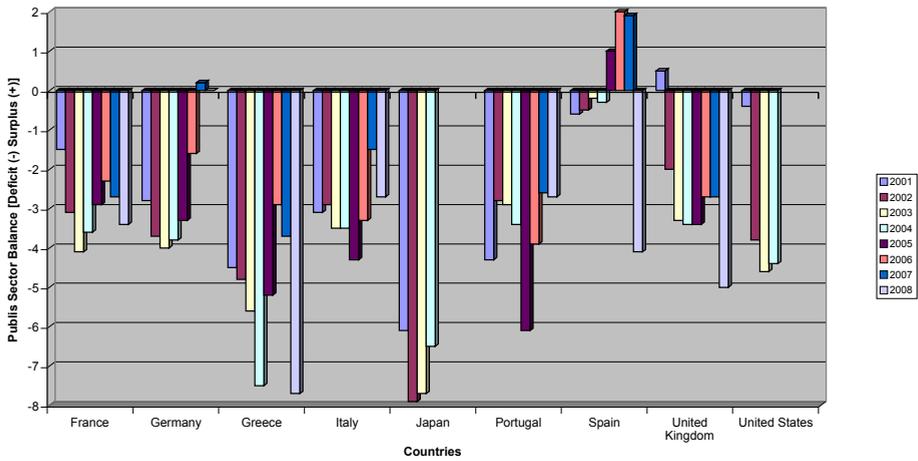


Figure 12. Public sector balance [deficit (-) surplus (+)] (In percentage of GDP).

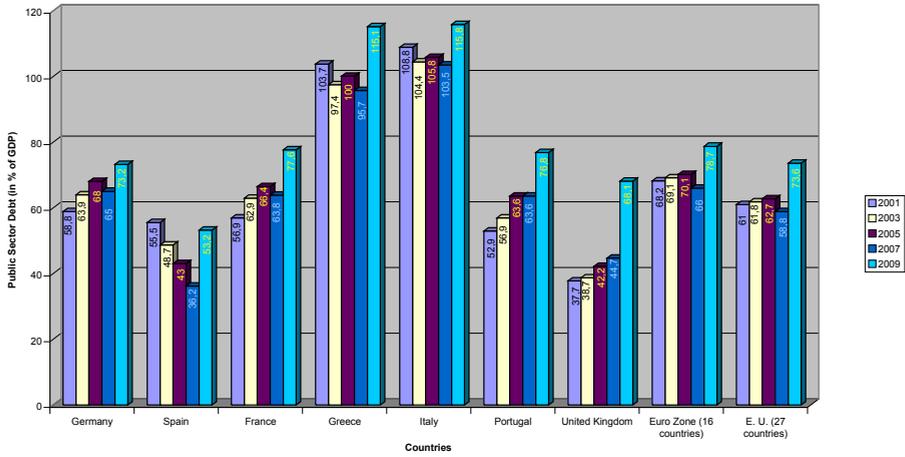


Figure 13. Public sector debt (In percentage of GDP).

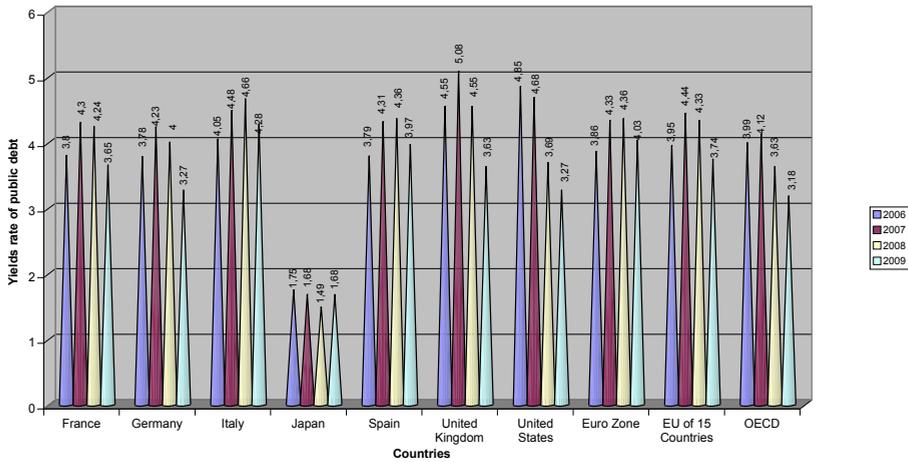


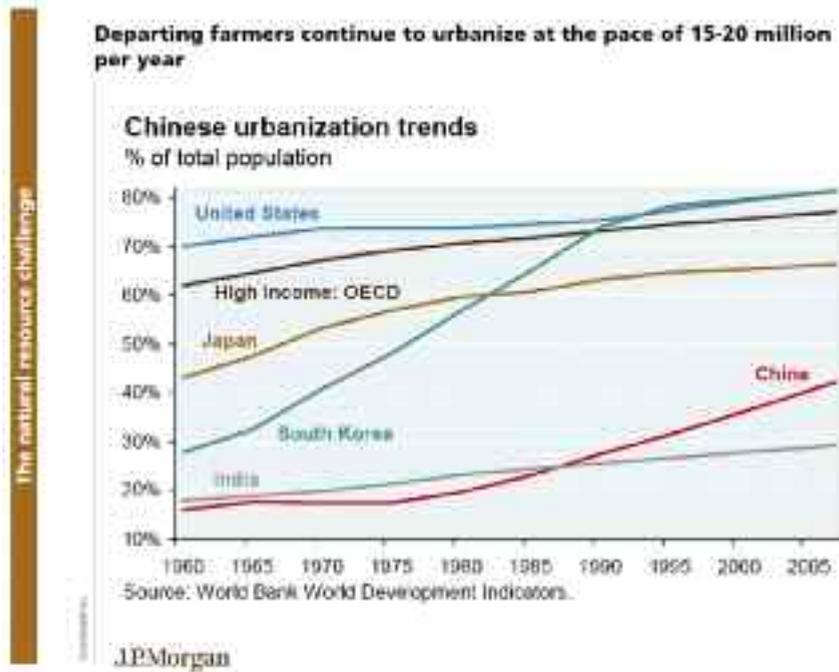
Figure 14. Yield of government debt issued at ten years maturity (In domestic markets).

Table 4. A CIVILIZATION-WIDE CHANGE: THE EAST COMING BACK  
POPULATION, GDP AND SHARES: 2000 AND 2040

	2000				2040			
	Population and (share)		GDP US\$ T.	GDP Share %	Population and (share)		GDP US\$ T.	GDP Share %
USA	282	(4.6)	9.6	22	392	(4.5)	41.9	13.6
EU	378	(6.2)	9.3	21	376	(4.3)	15.0	4.9
India	1003	(16.5)	2.4	5	1522	(17.5)	36.5	11.9
China	1369	(22.5)	5.0	11	1455	(16.7)	123.7	40.1
Japan	127	(2.1)	3.5	8	108	(1.2)	5.3	1.7
SE Asia *	381	(6.3)	2.6	6	516	(5.9)	35.6	11.6
LATAM **	530	(8.7)	4.1	8.5	961	(11.0)	19.7	6.4
Rest	2016	(33.2)	8.3	18.5	3371	(38.7)	30.1	9.9
DC	787	(12.9)	22.4	50.1	876	(10.1)	62.2	20.1
EC	5299	(87.1)	22.3	49.1	7825	(89.9)	245.6	79.9
World	6086	(100)	44.7	100.0	8701	(100)	307.8	100.0

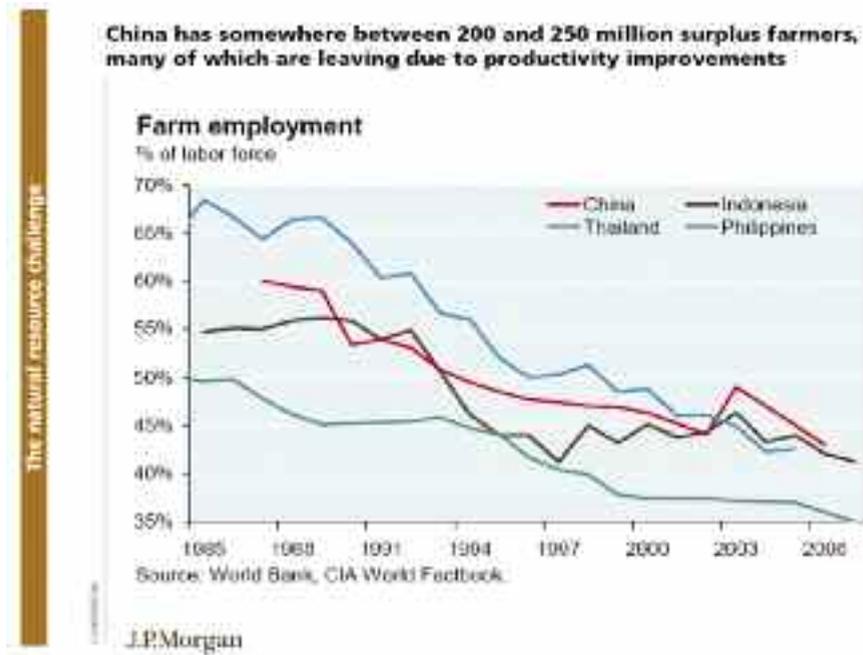
Notes: (\*) South East Asia includes Indonesia, Korea, Malaysia, Singapore, Taiwan and Thailand. (\*\*) In Fogel (2007) LATAM is included in the Rest of the World. In our Table it is separated and estimated by the author of this paper. Source: based on R. Fogel (2007 and 2009).

Graph 1. LEWIS MODEL'S ROOTS (I): RURAL POPULATION AND URBANIZATION TRENDS



Source: M. Cembalest (2009).

Graph 2. LEWIS MODEL'S ROOTS (II): RURAL EMPLOYMENT



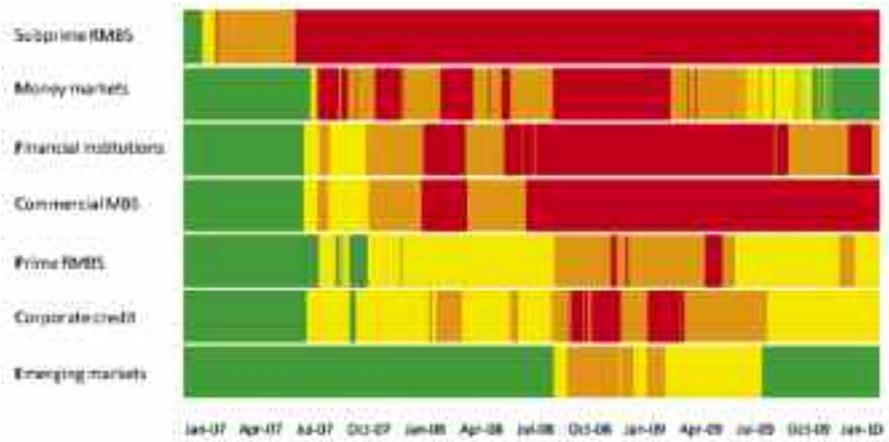
Source: M. Cembalest (2009).

Graph 3. MOBILE REVOLUTION



Source: *The Economist*, 25/9/09.

Graph 4. EMERGING COUNTRIES, NOW THE LESS RISKY FINANCIAL ASSETS



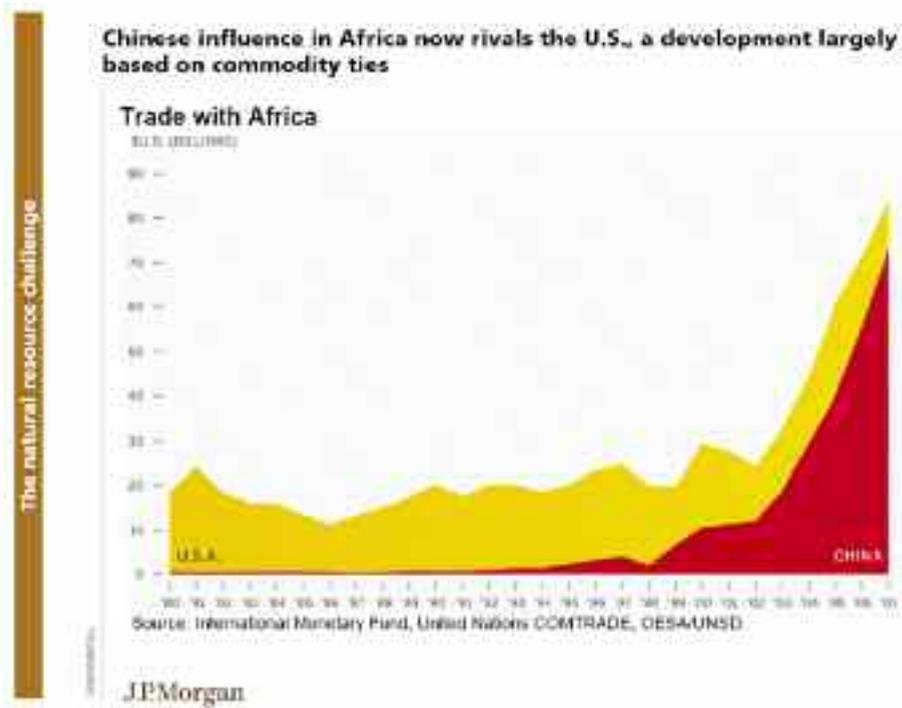
Source: IMF staff estimates.

Note: The heat map measures both the level and 1-month volatility of the spreads, prices, and total returns of each asset class relative to the average during 2003-06 (i.e., wider spreads, lower prices and total returns, and higher volatility). The deviation is expressed in terms of standard deviations. Green signifies a standard deviation under 1, yellow 1-4 standard deviations, orange 4-9, and red greater than 9.

MBS = mortgage-backed security; RMBS = residential mortgage-backed security.

Source: FMI, *World Economic Outlook*, April 2010.

Graph 5. CHINA PUSHES AFRICA



Source: Cembalest (2009).

Graph 6. ACCESS TO DRINKING WATER



Source: *The Economist*, March 22, 2010.