Crisis in a Global Economy. Re-planning the Journey
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GENERAL OVERVIEW OF THE MAGNITUDE OF THE CRISIS. THE GLOBAL COMPONENTS*

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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

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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'.[1]

[1] 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'.[2]

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 %).

[2] 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'.[3]

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%.

[3] 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'.[4] 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'.[5]

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

[4] John Paul II, Encyclical letter *Laborem exercens,* Rome 14.09.1981, n. 6.
[5] 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'.[6]

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 being 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

[6] 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'.[7]

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

[7] 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 mortgaged 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 being 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 economy, 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'.[8] In this way,

[8] 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 in 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*[9] is far removed from this and so too is Friederich von Hayek's call for the denationalisation of money.[10]

[9] *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.

[10] *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[11] in the United States, FSA[12] in United Kingdom, BAWe[13] in Germany, COB[14] in France, ASIC[15] in Australia, FINMA[16] in Switzerland or the CNMV[17] 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-

[11] Securities Exchange Commission (SEC).
[12] Financial Service Authority (FSA).
[13] Bundesaufsichtsamt für den Westpapierhandel (BAWe).
[14] Commission des Opérations de Bourse (COB).
[15] Australian Securities & Investment Commission (ASIC).
[16] Swiss Financial Market Supervisory Authority (FINMA).
[17] 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'.[18]

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,

[18] 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 that 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'.[19]

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

[19] 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 abundantly with all the costly trinkets which compose the splendid, buy insignificant pageantry of a court ... The same frivolous passions, which influence their conduct, influence his'.[20]

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-

[20] 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 opaqueness. 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'.[21]

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

[21] 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 inexpert 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 uncovered, 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 prescinds 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'.[22]

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'.[23]

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

[23] Benedict XVI, Encyclical letter *Caritas in veritate*, Rome 29.06.2009, n. 78.

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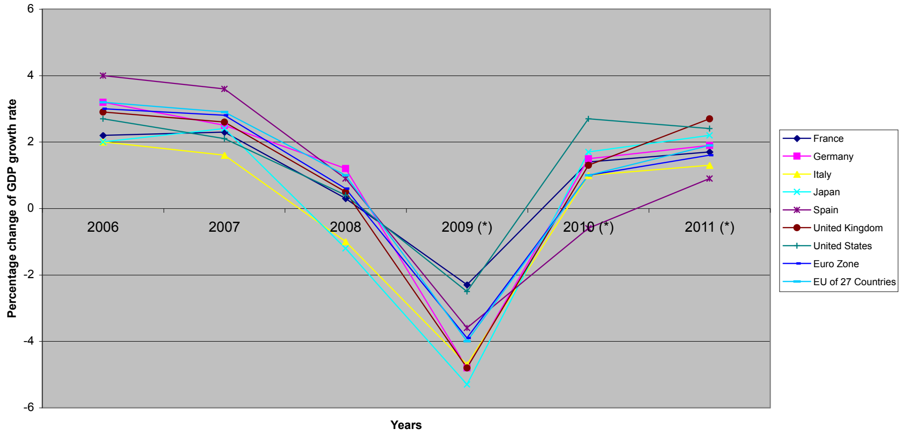

Figure 1. Total external debt at the end of period (As percentage of the GDP).

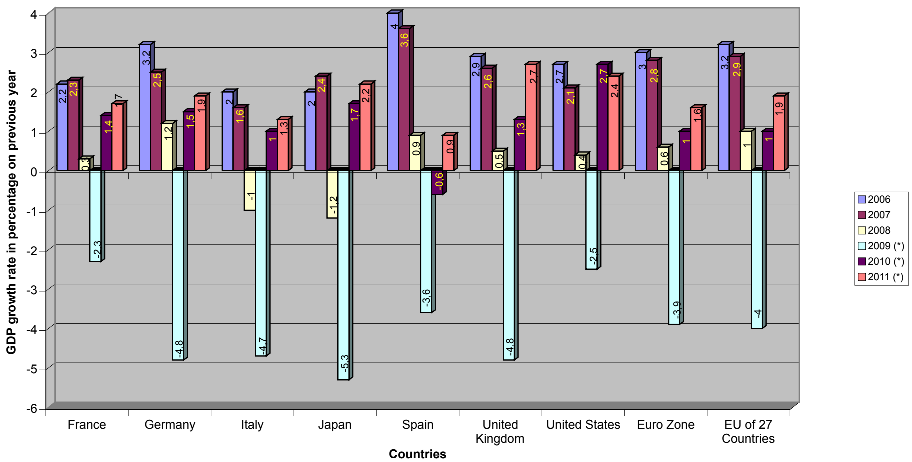

Figure 2. Real GDP growth rate (Percentage change on previous year).

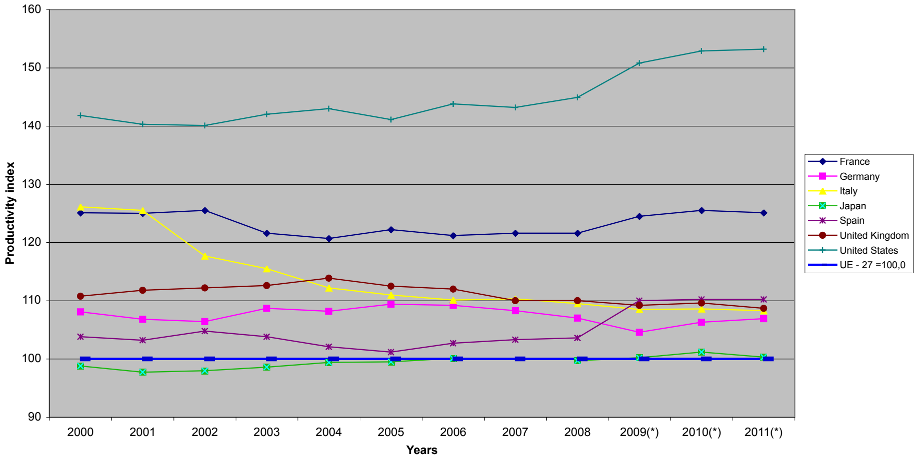

Figure 3. Productivity index refered to EU-27=100.

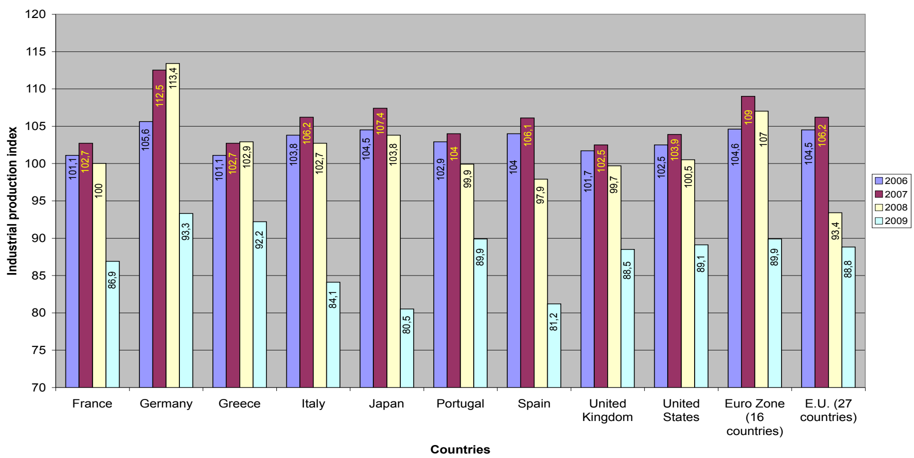

Figure 4. Industrial production index [2005=100] (Excluding construction).

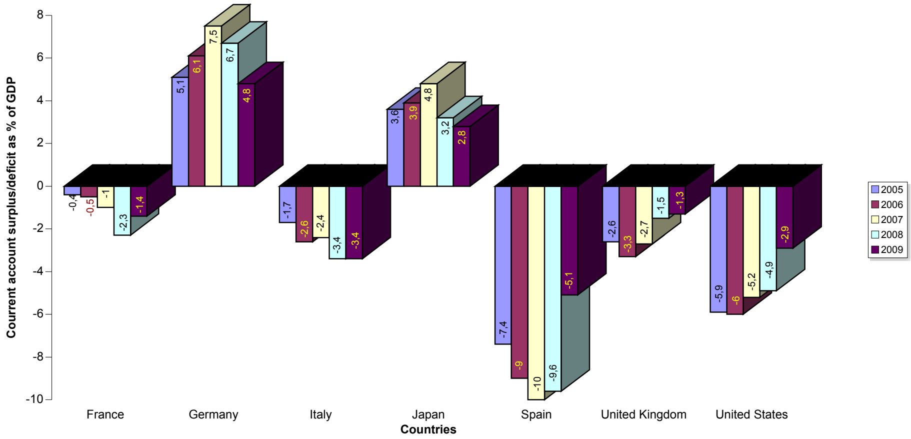

Figure 5. Current account balance (In percentage of GDP).

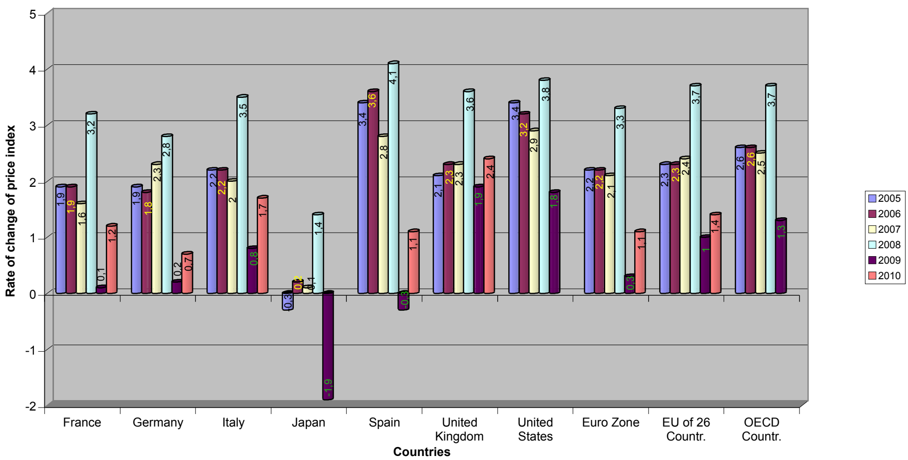

Figure 6. Harmonized consumer price index (Rate of change on previous year).

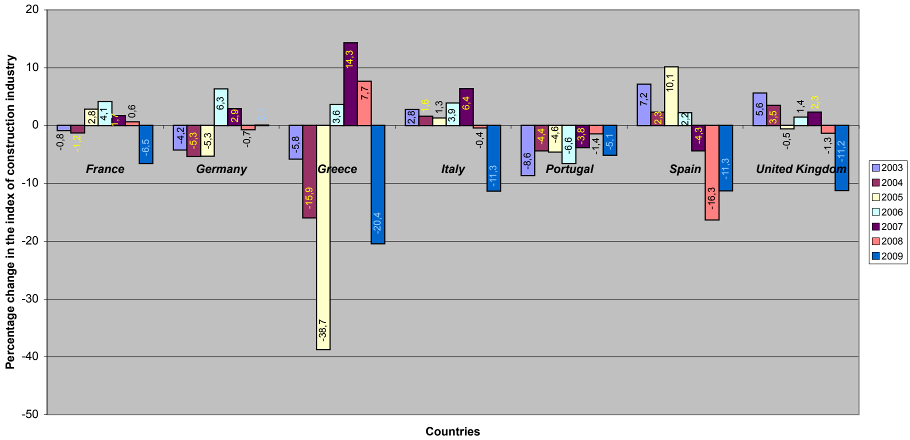

Figure 7. Index of construction industry (Percentage change on previous year).

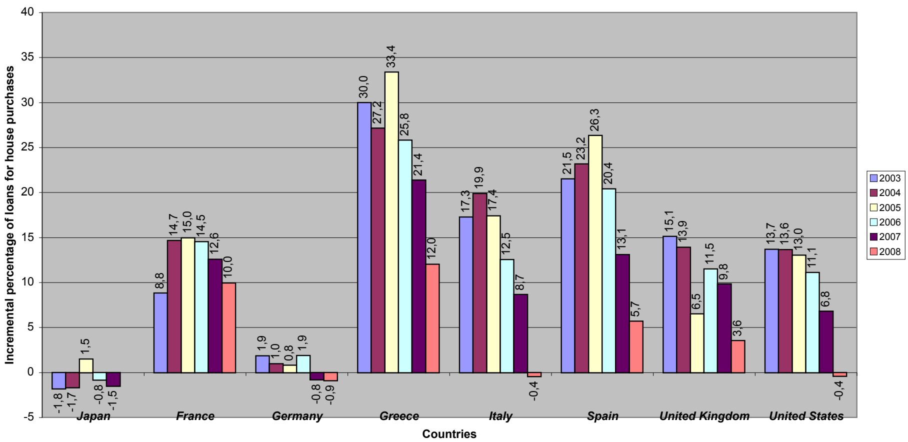

Figure 8. House purchase loans of households (Incremental percentage on previous year).

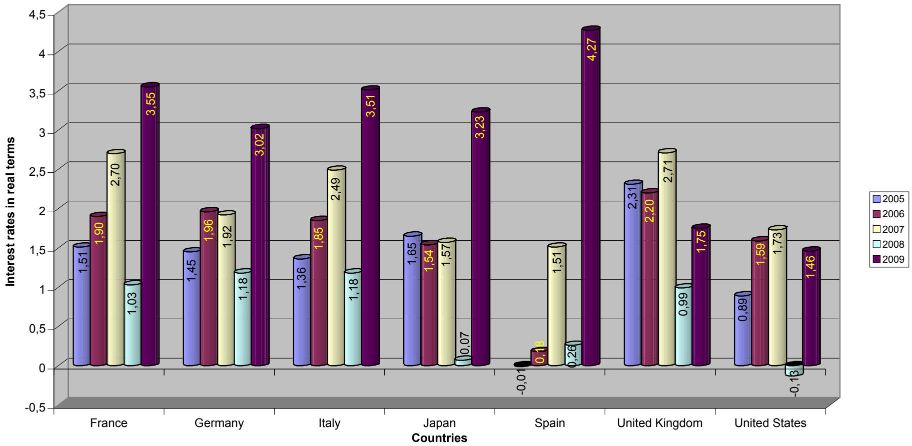

Figure 9. Interest rates in real terms (Nominal interest rate minus inflation rate).

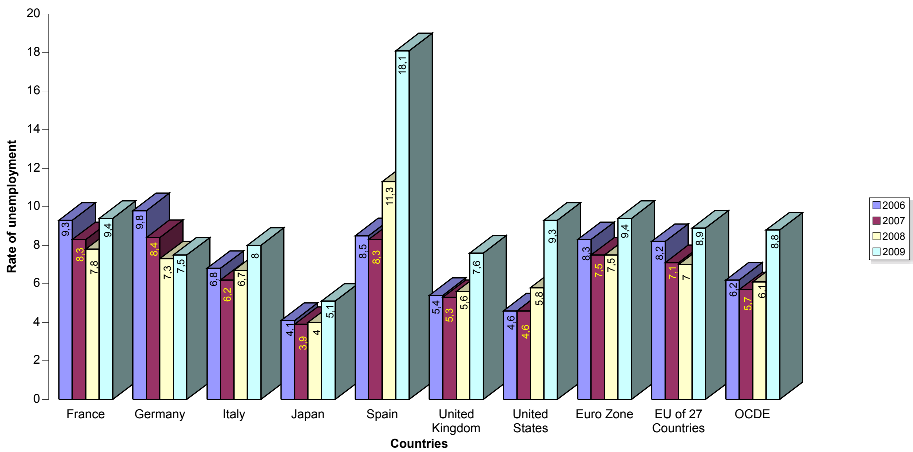

Figure 10. Rate of unemployment (In percentage on active population).

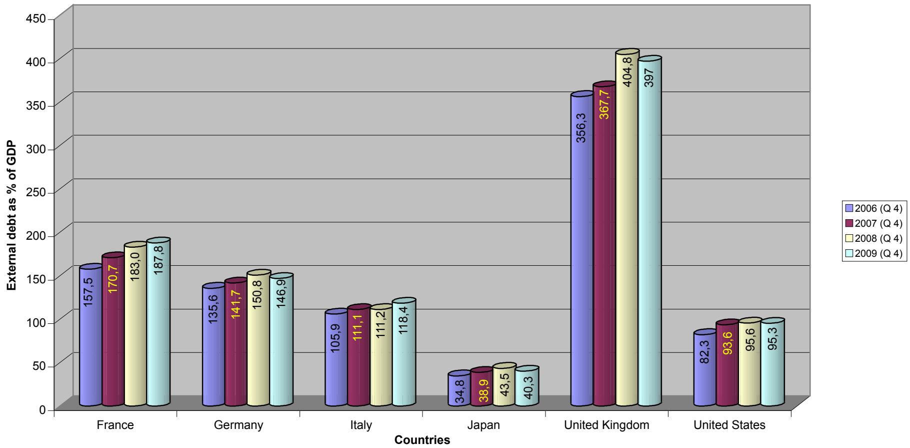

Figure 11. Total external debt at the end of period (As percentage of the GDP).

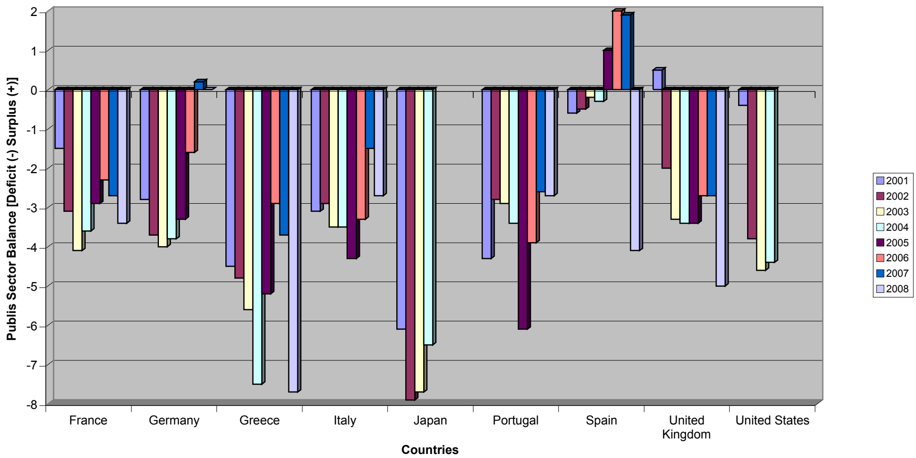

Figure 12. Public sector balance [deficit (-) surplus (+)] (In percentage of GDP).

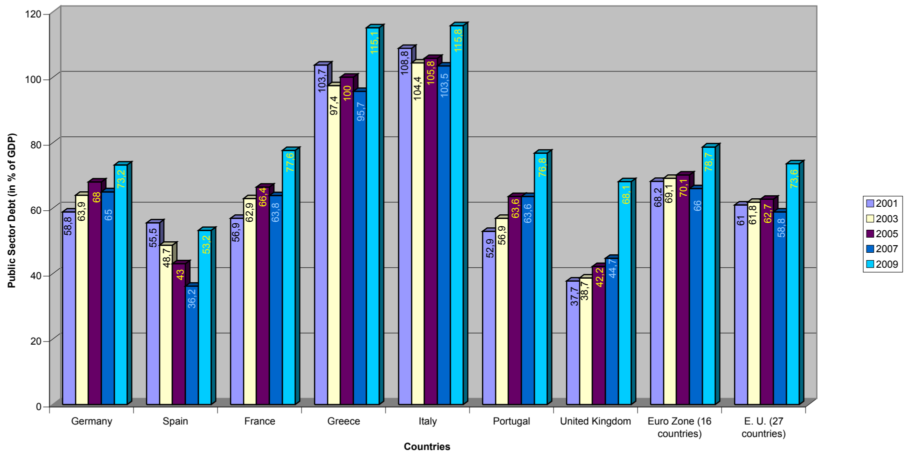

Figure 13. Public sector debt (In percentage of GDP).

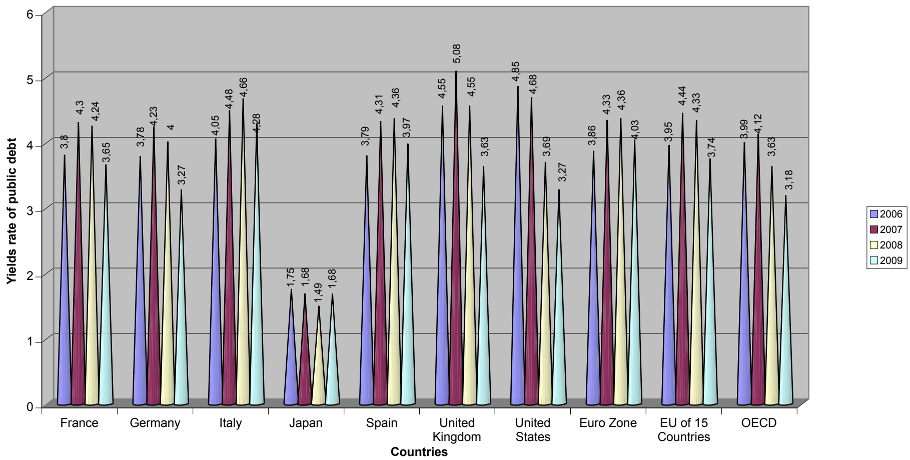

Figure 14. Yield of government debt issued at ten years maturity (In domestic markets).