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The debt crisis, financial reform and the common good. A synthesis of the discussion

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Introduction

The four sessions of the September 27-28 Consultation on ***The debt crisis, financial reform and the common good*,** involving Church leaders and theologians, alongside with economists, finance professionals and central bank leaders, offered many insightful perspectives. It is impossible to fully cover the wealth of analysis, policy evaluations, experiences and proposals that have emerged, so the main results are here summarized, with explicit reference to the name of participants who offered papers and presentations and participated in the discussion; the original papers can be accessed through links from the enclosed list of contents.

The key questions that were addressed can be summarized as follows: how can we contribute to building a bridge between common aspirations to global economic justice, solidarity, effective and equitable international financial reform, and the real decisions of policy makers, financial institutions officers, and finance professionals? How can we elaborate a better rationale in order for people to feel really responsible, and how to design governance for addressing inequality and justice? (Sugranyes) How to effectively realize a globalization of concern and solidarity? (Martin)

A unitary perspective, where finance can be true to its nature (CV 45), is indispensable for our generation to effectively face the current hardship and truly promote "wealth creation and development" (CV,65); yet, such perspective is not easy to find in contemporary culture, where the ethical dimension is more often juxtaposed than conjugated with economic and financial analysis and practice. On this regard, the Consultation offered a unique possibility of cross disciplinary, cross regional dialogue. The present synthesis of the discussion aims at highlighting those issues where a unitary perspective is most urgently needed, conjugating ethical foundation and technical expertise is most clearly at stake; issues that are at the crossroad where the complex world of finance meets the human aspirations to pursue the common good, i.e. the "good of being together" (Scola, FCA 2012). The Church's social teaching, offering an interdisciplinary and practical and experiential dimension, "is to be found at the crossroads where Christian life and conscience come into contact with the real world. This teaching is seen in the efforts of individuals, families, people involved in cultural and social life, as well as politicians and statesmen to give it a concrete form and application in history" (*Centesimus annus* 59).

1. The crisis and its causes: What have we learnt, what we still need understanding

"Why did no one see the crisis coming?" (Queen Elisabeth II, 2009)

What precisely went wrong?

Despite a number of financial crises occurred during the 80s and especially the 90s (inflation crises, currency crashes and debasements, asset price crashes), the recent crisis came as a surprise. There are indeed some specificities to the current crisis, and the sequence of market specific and country specific crises that the world has witnessed after 2007 is now ascertained, with a broad consensus on what happened. Excessive leverage, improvident lending practices, creation of new opaque financial products (Garvey) and their misuse are clearly part of the consensus explanation of the crisis.

While not new, these phenomena took an unprecedented dimension in the euphoric 'financialization' years. Hence, it is reasonable to question whether the root causes of the crisis have actually been addressed. The traditional function of finance, that is allocating capital though creation of assets, was vastly overtaken by the new function of allocating risk by trading derivative products, leading to exponential growth of over-the-counter (OTC) structured products. Notional amounts of OTC contracts outstanding is about 700 trillions of US$ - 10 times world GDP, although credit exposure (that is, gross market values after taking into account legally enforceable bilateral netting agreements) is much smaller (Dempster). From another point of view, in case of the euro-zone as well as in case of the US, the growth of gross debt (households, non-financial enterprises and public bodies) between 2001 and 2010 amounted to 3.7 times the growth of GDP (Dembinski) .
In a long run perspective , the financialization years can be clearly identified as they are characterized by the diverging profiles of 'real' economic variables – such as GDP and listed companies' operational returns – one the one side, and 'financial' variables such as market capitalisation of the same companies on the other side. While 'real' variables tend to grow at similar rates, market capitalization increases at much higher rates in the last two decades, as if current prices were to include all anticipated profits. In a sense, financial markets seem to specialize in 'selling the future', up to the point of actually 'emptying' it (Dembinski) . From a 'cultural' point of view, this behaviour appears to be driven by the desire to remove all risk from the real economy – with quite a different outcome.

Technological innovation allowed more intensive exploiting asymmetric information/power

More in detail, financial market developments of the last decades were driven by technological innovation, regulatory changes (most notably the repealing of Glass Steagall Act in the US), an exponential increase in over-the-counter (OTC) transactions, and especially 'derivatives' dealings (Dempster). The opaque, complex structures of most derivative contracts imply asymmetric risks that are not easily detectable by clients, leaving space for sellers to profit from exploiting the lack of information and of sophisticated computational expertise on the side of perspective buyers. In fact, structured products were often mispriced at inception, with conditions for clients getting worse over time. Estimates suggest that only a fraction (30%, possibly 20%) of outstanding contracts were signed with counterparts who were professionally able to assess the risks involved, while the rest was sold either to unaware buyers, or as a conditional requirement for receiving loans or refinancing (Dempster).

On the supply side, intensive exploitation of asymmetric information and negotiating power allowed huge profit margins for derivative dealers; on the demand side, other factors were at play, including the demographic transition, requiring to provide pensions to a growing share of aging population (Medova). While aging is both a problem and an opportunity (Quadrio Curzio), there is evidence that financialization is also driven, on the demand side, by the desire for material wealth security and for pension payments, both reflecting a cultural preference for a 'life without labour' (Dembinski) and for consumerism (Zahra).

'Bad' bubbles, and 'not-so-bad' bubbles

Trying to eliminate business cycles inevitably leads to bubbles. In a historical perspective, debt was required for reconciling capitalist business cycles with the need for stable consumption in democratic societies. After abandoning 'Keynesian' public demand management aimed at protecting people from business cycles because of its inflationary bias, a sort o 'privatized Keynesianism' emerged, where cycle stabilization was provided by extensive housing and other debt for low-medium income people and by unregulated derivative markets (Crouch, ref. by Coffman) and continues presently, although not very efficiently in the Eurozone with liquidity provided by the ECB to banks which divert it to supporting their country's public debt. This long run perspective on economic cycles leads to a policy question: can, and should, monetary policy mitigate business cycles? US monetary management in the 1990s seemed to have eliminated business cycles, but this result came at a great price in terms of short term asset price bubbles, creeping indebtedness of families, and neglect of physical and social infrastructures; yet, the recent crisis also prompted a "riding to the rescue". Cycle stabilization comes at a cost, as debt creates speculative bubbles; yet, the object of speculation does matter and some bubbles are more dangerous than others. If an asset-price bubble related to technological innovations collapses, the sound part of the 'new' economy remains; but bubbles that build around non-productive assets that are perceived as a store of value (such as houses) resemble Ponzi schemes, that disguise consumption for investment; their collapse tends to be particularly destructive. This reading of the recent crisis implies serious worries about the current policy stance, as by adopting very low interest rates the risk of re-inflating bubbles remains. (Coffman)

Once again, a 'confusion de confusiones'*,* (Dembinski, quoting J. De La Vega, 1688).

Excessive debt and misuse of innovative financial instruments are not new in economic history, unfortunately: in different degrees, all financial crises include them among their causes. So, why did nobody see the recent crisis coming? The answer to this question is cultural more than technical.

The present systemic crisis reveals many layers of confusion about what is the role of finance in 'merchandising time'. First, a confusion of present and future: leverage consists in melting present and future, to the point where the future is 'empty', as it has already been sold. Second, a confusion of ends and means, where the 'efficiency ethos' leads to the search for 'more' and not for 'better', with increasing manifestations of greed and dissolution of relationships. Third, a confusion of reality and 'virtuality': the risk-return paradigm is superimposed over reality, up to the point of reshaping reality itself. In short, the essence of financialization consists in the presumption that finance can take away the risks of the real economy – on the supply side, by packaging reality into financial contracts; on the demand side, by providing wealth security and the illusion of consumption without effort.(Dembinski)

Crisis is not just economic and financial, it is human (Oakley). To understand the crisis, we should ask the more fundamental question as to why in better-times very few adverted to the fact that the success and the sustainability of any economic model ought to have been evaluated in terms of the long term sustainability of jobs, mortgages and borrowing, of life style, of education and health care and sustainable opportunity for young people. Reflection on the economy had become decoupled from what the real purpose of an economy was and the people it was supposed to support (Martin). Ephemeral success, we could say, has all too often been confused with integral human development.

2. Regulation as a policy response to the crisis: what have we learnt?

> *"Finance is too important to be left to bankers" (Estanislao)*

Regulation is necessary

In the two decades preceding the 2007 financial crisis, financial regulation was largely perceived as *passé* and financial markets were accorded the status of those who 'knew better'. The same success of finance may have contributed (mostly national) supervision and regulations authorities to let the financial sector under their control to actively take part to a booming market, reaping the (mostly short run) benefits - and obviously to assume huge risks.

Financialization can and should be harnessed, though, for different reasons: to control cycles, to curb financial misbehaviour, but also because there are 'natural' limits to borrowing. (Dembinski). Obviously, de-financialization will be especially resisted by the same financial sector, as it drastically reduces profits (Dempster).

Supervision and regulations failures were often mentioned among the causes of the financial crisis (Martin, Garonna, Garvey, Estanislao) - although one could discuss whether individual failures resided in inadequate formal rules and supervision design, or in the actual decisions of supervisors. In all cases, the need for appropriate supervision and regulation was widely recognized in the discussion. Moreover, in some cases delinquency was the problem, requiring more decided action than improved regulation, supervisions and ethical codes; more decided moral sanction would be expected from the Church on the cases of clear delinquency and fraud (Camuñas).

Reintroducing regulation of financial activity, most notably by separating commercial and investment banks along Glass-Steagall lines, was mentioned as a particularly desirable move (Dempster). The need for realizing an integrated financial supervision and regulation architecture in the European monetary union was also clearly addressed (Bonnici). Despite limits concerning coordination, implementation, and impact assessment, post crisis supervision and regulation reforms seems to go in the right direction: the main areas where post crisis financial reform occurred were prudential regulations such as solvency ratio, liquidity ratio, leverage ratio, and some initial measures on global systemic institutions; other measures dealt with resolution procedure, and in some case with market structures, such as platform trading. (De Lauzun). Subsidiarity calls for diversified, competing-collaborating regulation (Garvey).

Regulation alone is never enough

While most participants agreed that regulations are necessary for financial transactions, quite a few of them supported the idea that regulations alone are *not* sufficient to deliver stable and equitable financial markets, for a variety of reasons. The most important is that human ethical decisions cannot be substituted by strict adherence to formal procedures; but there might also be unintended practical effects of regulation. Regulation does not deliver all that is expected by well-intentioned regulators, once regulations are incorporated in a technocratic structure. For example, credit is very likely to be allocated on the basis of computer driven algorithms, in a process that tend to de-humanize both the customer and the bank officer. The advances in technology (black-box trading programs, statistically driven debt collection technologies) and the ever increasing number of rules and procedures embedded in bank operation (30,000 estimated pages added to the rulebook governing US financial firms by Dodd-Frank financial reform; "Fair Disclosure" regulation) tend to reinforce each other in making investment a mechanistic, impersonal procedure for generating returns to the investors, and less and less a moral activity (Fieler). In short, where procedures rule, there is little space for ethical responsibility (Dembinski). Regulation may even provide space for the 'next' bubble to unfold, as it happened in the past (debate); furthermore, firewall regulations may even end up pushing a larger share of transactions into the 'shadow' banking sector (Garonna).

Discussion about financial reform should not avoid deeper questions, such as what is a 'good' financial market; what is the proper role of a bank – not simply what is a bank' proper structure (commercial/investment bank); what is appropriate proportion debt/own funds for financial and non-financial firms; and, more relevantly, how best to finance the real economy (De Lauzun).

Addressing size and complexity

Complexity has many dimensions; one of them is the fact that financial global realities have no global instrument to supervise them, and national interest still play a strong role in the very institutions where 'global' policies are formulated (Martin). Addressing both size and complexity of financial actors, especially multinational firms with foreign affiliates and global systemic institutions, is key for financial regulating (Dembinski); monitoring the overall leverage ratio of large institutions would however provide an upper boundary to systemic risk (Giraud).

Moreover, the financial industry is not a single entity: complexity calls for 'second best' options, where multiple structures complement and compete with each other, as no optimal regulatory structure can be thought to solve the problems, neither nationally nor globally. Regulation should be about containment of risk, in ways which are appropriate to financial size and role. The managers of saving banks and credit unions must be held to high levels of prudence – as the extreme risk situation that precipitated the crisis could and should have been stopped at a fairly low level of the hierarchy of financial institutions. The risk inherent in the complex, interdependent and highly networked financial industry, a 'risk management' style of regulation may be more appropriate; as delegating this activity to institutions themselves has proven disastrous, an independent regulatory body is required to oversee the risk structure of large financial firms. However, one should recall that capture remains an ubiquitous challenge, especially in consideration of the *de facto* 'revolving door' between employment in large financial institutions and as government officers, as they share a common culture (Garvey).

Crisis as an opportunity? A comparative perspective

One hard lesson of the globalization years is that economic ‘miracles’ tend to transform into disaster. Both South East Asia and Ireland went through deep financial crises, and there is much to be learnt from the two experiences.

Ireland’s miracle was built on foreign direct investments and open markets, and also a highly educated, culturally open and very adaptive workforce; when it collapsed, a ‘small government’ could not face a big crisis and the country had to seek a bailout from IMF, ECB and the European Commission. The austerity program was such that the effects of the crisis are being paid by the weakest groups in society, that is those who would most need social support. In the Irish case, post-crisis austerity programs imply that the coming generation will have limited access to social protection, education and health care – while a healthy, well educated workforce was exactly at the heart of Ireland’s earlier success, and remains a key factor in fostering the innovation and creativity required in knowledge based societies. There has never been a successful project of sustainable social development and inclusion which was not accompanied by sustained economic growth; but sustained economic growth has never on its own attained social progress. Rather, inequality and exclusion weaken society, damage the economy and breed instability. A sense of political ownership is required for austerity programs, as social and economic progress belong together (Martin).

Learning from South East Asian crisis management (Estanislao) can help better understanding the US and especially EU difficulty in providing solutions to the financial crisis, where evidence of a ‘credit crunch’ persists. A decade ago, South East Asia went through a many-layered crisis (debt, financial, economic, political, and social) caused by excessive lending, bubbles, inadequate regulations; yet, that crisis occurred in relatively small size economies that were relatively distant from the financial core of the global economy. While the Western countries had to face the ‘too big to fail’ problem, South East Asia faced a ‘too small to control’ issue; but the crisis left no choice but to introduce quick reforms, including consolidation, reforms in bank governance and in bank supervision, specific burdens on banks and financial institutions, stress testing, capital adequacy ratios. The initial austerity phase was followed by economic stimulus programs, and recovery followed within two/three years with intra-regional exports playing a powerful role in recovery and growth. Actions taken were often of a ‘second best’ type, possibly not efficient, but effective; bank nationalizations (which were reversed within three years, often by states selling at a profit), capital controls, accumulation of huge levels of international reserves. No East Asia government was politically impaired in introducing the necessary reforms, possibly also because of limited social and political participation. Still, the debt crisis became an opportunity to start a process of economic and financial reform, adding substance to which remains an unfinished business; and also an opportunity to experiment in regional economic and political cooperation (Estanislao).

3. Deleveraging and restoring growth

> *"Paying mortgages would have been cheaper that rescuing banks" (Dempster)*

Who pays for the crisis?

When a crisis erupts, the time comes for deciding who will bear the costs of adjustment. The most common choice has been to put the burden on debtors, with private debt partially transformed into public debt. Deleveraging, though necessary, is seriously hurting the real economy (Marseguerra), as unemployment end especially youth unemployment remains high, and the issue remains of how to combine it with acceptable living conditions and opportunities for decent work.

Despite the fact that the deleveraging process has only just begun - in relative terms with respect to the size of the debt problem, there is the urgent need to alleviate the credit crunch. This requires acting on alternative sources of funding, such as public funding, expansionary monetary policies such as quantitative easing or outright monetary transactions; and recapitalization. Furthermore, it requires strengthening the non-bank sources of financing small medium enterprises (such as private equity and securitization of SME loans) and infrastructure development (project bonds, private-public partnerships). (Garonna).

The road ahead remains hard to pursue, as there remain to struck the appropriate balance between quantitative easing/recapitalization and fiscal consolidation on the one side (Quadrio Curzio), deleveraging and debt rescheduling on the other side (Pastor). Anarchical rescheduling, though, may easily end up to be both ineffective and unjust; hence, orderly rescheduling should be organized before the anarchical takes place. Deleveraging has in fact an important distributive dimension, as the debt of someone is the future of someone else. Here, the logic of the Jubilee as a form of deleveraging can be reappraised (Dembinski).

Towards the energetic transition

There are three basic configurations for macroeconomic equilibrium: a combination of growth plus inflation, as in the post-WWII '30 Glorious Years'; deflation, as in post 1993 Japan; speculative bubble – up to the point where the bubble bursts (Giraud). This third configuration resembles post 1980 Europe, where anti-inflationary policies are designed in order to control goods prices, not asset prices. In this case, the combination of securitization and low interest rates keeps fuelling a potentially dangerous bubble. Debt/GDP ratios for different groups of agents remains very high in the Euro zone, with the financial sector debt exhibiting the fastest growth; there is also evidence that bank credit does not reach families and businesses, which currently suffer from a serious credit crunch, as it previously happened in 2009. This fact points to the special need for deleveraging in the financial sector. Revisiting the years which preceded the crisis, one should consider who actually bears the moral responsibility of extending loans to borrowers that find themselves in the practical impossibility of paying back. For example, US households debt in 2008 was about three times the total value of US residential mortgage market in 2002; in Europe, Greece stands as a case where no austerity will be sufficient to provide for repaying Greece debt. The moral question remains of who should pay for insolvency, in a world where leverage has reached unprecedented levels (Pastor).

This question on post-financial crisis macro management can be set in a broader perspective which considers 'real' dynamics and focuses on the 'energetic transition' (Giraud), at a time where 'Keynesian' stimulus seems not to accomplish significant results in terms of fostering economic growth. Furthermore, a disturbing correlation emerges, where the price of energy seems to be a major explanation of most recent macroeconomic cycles. Considering 'real' dynamics, there is strong evidence of a linear relation connecting real GDP and 'physical' measures of energy consumption (as opposed to expenditure for energy consumption, which includes oil price dynamics); studying the decomposition of per-capita GDP growth into growth in per-capita energy consumption and growth in energy-efficiency in production, such decomposition points to need of decidedly address the issue of energetic transition to less oil-dependent economies, where 'green' job creation can add to economic development (Giraud) .

4. Some lessons learnt on regulation and deleveraging

> *"Let not financial crises go to waste"* (Ramsey, quoted by Vanni d'Archirafi)

The way forward: combining 'top down' and 'bottom up' initiatives

Applying subsidiarity appears as a practical way forward for both keeping the negative side of deleveraging under control and for providing new tools of financial performance. Collaboration and division of labour between the State and the individual, the public and the private sector would include for example designing a mixed public-private social protection system. In the field of financial governance, we need devising effective forms of 'glocal' governance – from local governments and communities, NGOs, business associations, new media and social networks, to international organizations and macro-regional initiatives for financial cooperation (most notably the EU banking union). We also need including new players in finance, such as venture capital and private equity, micro financial institutions. To support collaboration among a variety of public and private agents, top down initiatives such as legislation, regulation, supervision, are to be complemented with bottom up tools, such as education and training and ethical responsibility (business ethics, in a variety of areas including management practices, compensations, anti-corruption, social responsibility) (Garonna)

Business responsibility in a changing world

Three powerful forces are reshaping the financial and business landscape: globalization, urbanization and digitization (Vanni d'Archirafi) . Globalization is best seen as a network connecting urban centres, than where economic turbulence is mirrored also due to geopolitical turbulence, both within countries (as with the 'occupy' movements) and across countries (where power shifts are becoming ever more visible). This new scenario, risky and volatile, goes with the need to face environmental, employment, poverty, migration issues: too big for any sector of society to deal with. Hence, an important sector as the financial system is called to explore possibilities for a collaborative approach, so not to be part of the problems but part of the solution. This is already happening, and many experiences testify that social purpose and sound business need not be in opposition to one another; among them, initiatives to support government transition from cash to digital payments to promote financial inclusion; to bring the un-banked population (2.5 billion people according to the World Bank) into the formal economy through mobile phone connections, thus empowering people by making them less vulnerable to theft and exploitation and promoting economic growth; micro-finance initiatives; using the suppliers' receivable and corporations' own credit standing to support sustainable supply chains, and so on. This new ‘cooperative’ mindset conjugates social engagement with good business (Vanni d’Archirafi).

Ethics is indeed the best investment (Rusche). Businesses which embed sustainability in their operation are winners over the longer term, as the responsibility that an enterprise takes for the social, environmental and economic impacts (positive and negative) is a pre-requisite for customer acquisition and retention on the one side, and for being a business partner of choice to their suppliers; it is essential for recruiting and retaining top talent and it is clearly at the heart of giving back to those communities in which they operate. Responsible Business is not about how to disburse one’s profits, but how firms makes profits, treats the planet, their communities, and other firms in their supply chain (Vanni d’Archirafi).

Beware of excessive, impersonal debt (and credit!)

Debt is, almost by definition, the root cause of systemic risk. There remains a valid intuition in the church’s old times reluctance towards interest lending (usury), namely that debt should be a subordinated and limited form of financing investment. This statement is valid because of risks involved in debt issuance; but its validity is even enhanced when debt becomes impersonal, not associated to a real partnership (De Lauzun). The incidence of banks’ debt may be a plausible explanation of banks becoming ‘decoupled’ with respect to the economy (Zurlo).

However, one must consider that, almost by definition, debtors and creditors are such that one does not exist without the other, and co-responsibility should be the appropriate ethical response to financial crises (Garonna). Unfortunately, the ‘relational distance’ between creditors and debtors may be such to make co-responsibility impossible, and crisis resolutions both slow and painful.

5. The case of Europe: economic, institutional and ethical challenges

> *“(A)n authentic European "common home" cannot be built without considering the identity of the people of this Continent”* , Benedict XVI, 24 March 2007

Deleveraging and reforming in Europe

Among the alternative ways to deal with excessive debt, the prevalent direction taken in the EU has been to charge the burden on debtor – as opposed to restructuring the debt and preserving the financial system, as in the US, or nationalizing financial institutions as it was the case after the South East Asian crisis (Pastor). In the Consultation, the European way of dealing with the crisis, which must include facing the issue of European private debt, was addressed in the context of the overall political reality of the European institutional architecture and its ongoing efforts of reform. Despite its shortcomings, which the crisis put in clear evidence, the EU institutional experience continues to represent a *unicum* in sovereignty sharing among diverse nations, which provided an unprecedented of economic progress and peaceful relations; hence, learning from both EU accomplishments and shortcomings is crucial for addressing issues of global governance.

The many layers of crises in Europe

The most serious manifestation of the crisis in Europe lays in its social ramifications, and especially in unemployment , which is particularly severe in some countries and in some social groups, such as youth. Unemployment is accompanied by wage stagnation, reduced welfare, growing poverty and inequality both within and across countries; as a result, divergence across Euro area member states continues to increase. As to the factors behind the crisis, a major structural feature is the large volume of indebtedness: accumulated government debt as a percentage of GDP, for the advanced economies, is now peaking above World War II levels. This implies the room of maneuver for governments is exhausted, and financial adjustment required, in times when financial market trading involves huge amounts and can use – and abuse – financial tools which were initially intended to mitigate risk, such as Credit Default Swaps (CDSs), 80% of which were estimated to be pure speculation. Speculation fueled asset bubbles, and also contributed to mis-pricing of risk; this was the case also within the Euro area. The icon of mispricing of risk for the Euro Area is represented by yields on 10-year sovereign bonds: different countries yields were originally spread across a broad band; but with the creation of the single currency, participating countries experienced a sudden convergence of bond yields, as investors disregarded national differences in real competitiveness and fiscal soundness, and the yield spread narrowed. The sovereign debt crisis reversed the situation, with yields diverging and becoming highly unstable once again. (Bonnici)

Accomplishments and shortcomings

Many ethical shortcomings can be identified behind the European ‘financial plus sovereign’ crisis: excessive leverage on the side of financial institutions, regulatory oversight failing in monitoring market developments, indebted countries losing the opportunity to avail themselves of favorable bond market conditions for implementing structural fiscal reforms. Nonetheless, the European response to the crisis included significant fiscal consolidation, improved policy coordination, and ‘solidarity driven’ actions such as the creation of the European Financial Stability Facility evolving into the European Stability Mechanism. The European Central Bank in particular took immediate action, by facilitating access to credit also with ‘non-standard’ measures and by launching a new measure – Outright Monetary Transactions – to provide an effective backstop in the sovereign bond market, removing fears about the future of the common currency that were undermining the stability of the Euro. These support mechanisms are tangible and effective forms of solidarity (Bonnici).

The crisis revealed the need to address the shortcomings in the European institutional framework, most relevantly in the field of cross-border financial supervision, and to move towards the completion of the monetary union by way of a synergic move towards banking, economic, fiscal and political union (EU Council, June 2012). In a broader perspective, the current crisis obliges EU citizens to rethink the moral framework underpinning EU economic and political institutions, where solidarity (especially intergenerational solidarity) and subsidiarity need to be effectively realized in actions. Policy models that allow macroeconomic imbalances and excesses to remain uncorrected and which rely exclusively on the self-regulation of markets are ethically not acceptable and need to be corrected. The same applies to fiscal policies that allow the accumulation of excessive levels of debt. Such policies are not only unsustainable but they also negate solidarity between generations. In addition, free-riding, which allows a state to avoid its fair share of the burden of correction, passing it onto other states and thereby adding to the risk of contagion, is to be replaced by prudence and participation at all levels, including governments, regulators, financial institutions, businesses and households. In this manner, unemployment and increasing inequality, within and across countries, can be more fully addressed (Bonnici).

The Euro is a political reality, but the Maastricht design needs updating

Euro is indeed at a crossroads. The sovereign crisis exposed the fault lines of the Maastricht approach, with two alternatives: either keeping the Maastricht approach and 'dropping' some countries, or moving forward, towards the completion of the monetary union, recognizing that the Euro is a political reality to be preserved and reinforced (González-Páramo). The crisis made it clear that the Maastricht design, characterized by a single currency, some fiscal policy coordination, no economic policy coordination and ultimate reliance on 'market discipline', is ultimately not viable: while it implied a minimal loss of national economic sovereignty, it also included very limited elements of shock absorption and reciprocal insurance. The lack of credible crisis prevention and resolution mechanisms, combined with policy mistakes and strong initial resistance to move forward, led to unprecedented pressure on the monetary union itself. Two phenomena became apparent: first, solvent sovereigns losing access to a risk-free liquid asset; second, solvent companies losing access to cross-border funding. The visible consequences were sudden stops in investors' decision to fund peripheral countries (especially small-medium enterprises in peripheral countries) and the actual breakdown of the monetary policy transmission mechanism; as a consequence, serious socio-political tensions related to credit crunch and fiscal adjustment were associated to 'redenomination' risk – i.e. with the break-up of the Euro Area.

A banking union for Europe

Lacking significant progress on integration, the European Central Bank can provide only temporary relief; hence, the realization of a banking union is vital for preserving the monetary union itself, stopping 'diabolic loops' that would otherwise make sovereign debt crises unstoppable. Consider a negative shock in sovereign bonds of a member country (say Greece); contagion will put at risk other member countries (say GIPSIs). Now, contagion in sovereign debt markets creates a banking problem, that will ultimately feed into the real economy as a recession, that will validate the initial negative attack in a sort of self-fulfilling mode. More in detail, the 'diabolic' transmission mechanisms can be summarized as follows: as GIPSIs' public debt depreciates, this reduces the value of bank's assets, leading to a banking problem – which may require public funding, thus reinforcing fears of sovereign insolvency. A second 'diabolic loop' works through deposit flights and evaporation of wholesale funding due to fears of sovereign insolvency; the subsequent tightening in lending aggravates recession in peripheral countries; but recession implies larger deficits, thus reinforcing depreciation of GIPSIs sovereign debt. In sum, the absence of a deep and irreversible degree of financial integrations threatens the fungibility of money, which is the very essence of the single European currency. Realizing the banking union is necessary for 'Euro 2.0', including a single rulebook, a single supervisory mechanism, a central banking resolution authority, and an integrated system of deposit guarantee. All these elements are required for breaking the negative bank-sovereign feedback loops, and for restoring the conditions for a single monetary policy in the Euro Area: there are no 'plan B' (González-Páramo).

Beyond the EU banking union

Two cautionary remarks may be added. While the banking union is necessary, it needs to be accompanied by other country-specific structural reforms (Bonnici). As there remains a strong home-bias in banks' behavior, the banking union alone is no panacea for alleviating the credit crunch in financially peripheral countries. Moreover, when these countries borrow in Euro they are actually borrowing in a 'foreign' currency (a peculiar version of the so-called 'original sin' faced by many emerging countries), and this tends to reinforce instability and make adjustment more difficult (De Lauzun)**.**

The process of realizing the banking union is anyhow proceeding, although there remain some uncertainties on single resolution and single deposit guarantee; but there are deeper implications for achieving the stability of the Eurozone. One concerns the issue of how to deal with sovereign debt – both legacy and new issues; the second concerns how to move towards the fiscal and political union. As to sovereign debt management, different proposals emerged such a Debt Redemption Fund, for dealing with the legacy from the past, and Eurobills, for mutualizing short term debt (González-Páramo).

The Prodi/Quadrio Curzio proposal of Euro Union Bonds (EUB) was also recalled. Europe perspective real infrastructure investment in view of realizing "Europe 2020" is huge (1.5 to 2 trillion euro), and requires financing innovation. According the EUB proposal, bonds are issued with a guarantee by real assets including gold reserves, so that innovative growth can be financed. Gold reserves plus other real assets could provide one trillion paid-up capital; a leverage of three would suffice to finance real investment (Quadrio Curzio).

6. Finance, politics and the common good

> *"Creating globalization of concern and solidarity … in an interconnected system of unequal agents" (Martin)*

The common good as concrete horizon for solidarity

The Consultation offered a vivid representation of the challenges each and all of us face in the present situation, where many layers of the crisis intersect and where responsibility of events are actually shared by many actors - all too often acting on a narrow perspective, lacking that 'loving intelligence' (CV 30) that makes it possible to perceive the common good, i.e. the good of the 'all-of-us'. As we, the 'all-of-us', are connected by objective interdependence, the common good requires accurately 'mapping' interconnectedness. Such 'intelligence' is necessary for the common good to be concretely pursued with the loving attitude of solidarity. A 'loving intelligence' transforms the common good from a merely rhetorical reference, possibly mentioned for opportunistic reasons, into a concrete horizon for action.

Global financial governance to serve the common good

The PCJ&P offered some "Reflections" that are intended to point to the way forward for financial and monetary markets to serve the common good of the human family. They must be free, stable, transparent, "democratic" and not oligarchic, functional to the real economy and to businesses, workers, families and local communities. Financial markets are ’collective good’ and ‘public good’ that must respect all canons of justice for the good of the human family. Global institutions, in particular, must be consistent with global realities and problems, in a democratic, representative and participatory way. Hence, reforming the international monetary and financial system is not a ‘neutral’, merely technical process: it must be shaped according to *anthropological and ethical requirements*.

On the way to creating a world political Authority, issues of *governance* (that is, a system of merely horizontal coordination) cannot be separated from those of a *shared government* (that is, a system which - in addition to horizontal coordination - establishes a *super partes* higher authority) which is functional and proportionate to the gradual development of a global political society. Three more specific reflections which were offered in the PCJ&P “Reflections” document (namely the taxation measures on financial transactions, the conditional recapitalization of banks with public funds, and the distinction between commercial and investment banks) remain relevant, and some progress towards their implementation has been made in different countries over the past two years (Toso).

The space for discussing financial problems and solutions coincides with the space of political debate and proposals: technical competences are essential, ‘technocratic’ approaches are no solution (Salmeri). Affirming the primacy of the political dimension in preventing crises and facing their consequences, though, does not coincide with affirming the primacy of national policies as such. The primacy of state policies has been challenged as being part of the problem, not part of the solution (Diotallevi, Felice). When the nation state crystallizes as an institution with a sort of monopoly power over the common good, the state itself becomes inadequate at pursuing such a good, both locally and globally. While the ‘poli-archic’ structure of modern social order was shaped internally to the Christian tradition of Europe , the ‘mon-archic’ order that subsequently prevailed affirmed the primacy of state politics over society; but the ‘state’ solution is impracticable in times of globalization and of enhanced functional differentiation of society. The present social complexity does command a plurality of political agencies, more specialized and more internally diversified. Obviously, the demise of the state does not imply the demise of politics (Diotallevi, Felice).

Subsidiarity for the common good

Our times are witnessing a transition from an era of ‘states’ to an era of ‘cities’: this transition calls for the realization of *horizontal* subsidiarity (as in *Centesimus annus*) and poli-archic social governance (as in *Caritas in veritate*). In both the social theology tradition and in the *Magisterium*, autonomy and poli-archy represent the conditions for the common good, where tyranny on the one side and anarchy on the other can be kept under control (*Dignitatis humanae*). (Diotallevi, Felice)

Many interventions pointed also to the relevance of multilateral and regional cooperation, as they represent possible and necessary forms of realizing a system of governance. The regional perspective was present in the South East Asian experience (Estanislao), and obviously in the European experience; the regional dimension is also highlighted in the PCJ&P “Reflections”. Enhanced multilateral and regional cooperation (*vertical* subsidiarity) are necessarily part of the effort to provide regulation and transparency to global financial markets.

Subsidiarity contributes to the common good also when it is practiced within the economy, in the internal governance structure of financial firms. Bank branch managers are in charge of local marketing rather than local underwriting, fragmenting the core functions of commercial banking and making it less likely that the loan underwriter will have a personalized relationship or community connection with the borrower. This result in a loss of 'good'. There is a growing evidence that centralization and automation of underwriting is also producing inferior outcomes as compared to distributed, personalized and responsible decision making; in other words, trust generates efficiency (Fieler).

Healthy diversity of financial institutions is necessary, but we also need "righteous" man and women to function within the financial sector (Garvey). In sum, the way towards financial reform includes the strengthening of ethically structured banking institutions, embodying the "principle of gratuitousness" and the "logic of gift"; the democratization of finance, as a result of civil society engaging in 'another' way to run the economy (corporate social responsibility, ethical finance, fair trade); the renewal of university *curricula* and proper spirituality, towards a new capitalism that is ethical, owned by people, imbued with "passion" that comes from competence, gift and gratuitousness. (Toso)

Power relations and the common good

Global realities, today, are not matched with global instruments to supervise them. Who might be, in fact, 'global regulators' in a multi-polar world? Can such authority truly be worldwide? Abstract reference to the 'international community' as a player in global governance is non-meaningful, despite its positive connotations: on the one side, supranational power is very limited in the economic sphere, being limited to WTO Dispute Settlement Body; on the other side, the same concept of 'territoriality' has become relativized and unclear, as it is connected to power asymmetries. Foreign companies, for example, may be able to negotiate packages with governments which are so favourable to seriously reduce the economic space for local companies to emerge. In general, in today's globalized world, territoriality has become much relativized, as transnational businesses make it difficult to determine where activities are domiciled – and this is prejudicial to taxation and regulation. (Martin).

Initial steps in addressing financial firms' power issues at a global level have been made by BIS by mapping Global Systemically Important Banks, G-SIB (Dembinski); geopolitical transformations which imply significant power shifts (say, the monetary and financial role of China, both regionally and globally) have been mentioned during the Consultation, but not explored.

7. Finance and ethics, at the crossroads where Christian life and conscience meets the world

Can the current crisis be an opportunity to chart a new course, more respectful of the human person and of the common good? (Zahra)

Addressing questions of meaning

There is a sincere demand among finance people for addressing questions of meaning; not as a theoretical question that can be satisfied by theoretical answers, as the urgency of the question comes from the distress of experiencing dis-integrated lives (Fieler) and form aspiration at reconnecting the financial, ethical, human dimensions of one's life (Vanni d'Archirafi)

Two particular experiences were mentioned during the Consultation: the conversations held at St. Paul's, in the City of London, under the title "*The City and the Common Good. What kind of City do we want?*". The practical meaning of what 'good people', 'good money' and 'good banks' mean was addressed by outstanding speakers, among them the Archbishops of Canterbury (Anglican) and of Westminster (Roman Catholic), Justin Welby and Vincent Nichols, and subsequently discussed. In these conversations, theological reflection was crucial in providing "a robust definition of what human wellbeing looks like and what the rationale is for human life well lived in common" (R. Williams, quoted by Oakley), thus providing the space for a vital discourse about how each of us becomes more recognizable to oneself. In fact, our decisions show us who we are: money is a metaphor, and our monetary exchanges are revealing about our real goals: profit, or survival; or a 'good life'. Hence, the vision of 'good' City - a vision of good people bound together by good purpose - needs to be internalized and personally appropriated. (Oakley).

The Catholic Finance Association also hosted similar meetings in New York, discussing *Caritas in Veritate* discussing, with partial success as the encyclical tended to be mostly interpreted in political/policy terms. Yet, it is only possible to make the financial system more just with a conscious participation of financial professionals themselves. Efforts to restructure global finance, absent a change in the hearts and minds of financial professionals, will likely aggravate the situation, as the combination of 'regulation plus technological change' is likely to push towards a further de-humanization of finance; but much of the de-humanization can only be resisted by financed professionals consciously putting the person at the centre of finance and living more integrated lives. That is, reforming global finance one banker at a time (Fieler)

Economics and ethics

The world of finance and the common good do not represent two different, independent spheres that need unlikely ex-post reconciliation, or reciprocal adjusting, as no human decision is merely 'technical', or 'neutral' (Scola FCA 2012). 'Sentiments' matter in financial markets: fears and anxieties – not just cold reasoning – are part of the reality of markets. Markets are human and social realities, hence economics and ethics are inevitably linked: economics belong to the framework of ethics, and ethics belong to the real world. In the real world, there are concrete non-market needs to be addressed (John Paul II), and we experience gratuitousness (Benedict XVI): hence, solidarity and reciprocity can and should be experienced *within* economic activity (Martin). In facts, *oikonomía* belongs to the field of ethics (Salmeri).

Financial reform especially calls for abandoning the dichotomy economics *vs* ethics, typical of an economic paradigm where the logic of gratuitousness of human relationships is extrinsic to the economy. The dichotomist paradigm is based on a specific notion of the individual agent, which is driven by needs and rationally acting; possible altruistic aims are superimposed and variously motivated (as in the case of donating because of the 'warm glow' that comes with giving). Even corporate social responsibility may fit into the dichotomist paradigm, when profits are pursued according to an 'economic' logic, and 'ethical' initiatives are subsequently added. Rethinking the paradigm calls for a different vision of the person, not as an individual but rather as a relational being, and most notably 'familial' being. In this vision, the logic of gift consists in giving not in an abstract 'dis-interested' sense, but in order to create a relationship: *inter-esse* (interest) means "being with", so that the act of giving can be truly 'interested' in others. It is the family the primary space where people can learn how to conjugate giving and interest. Ethics is not a list of 'noes', or a series of extrinsic rules and limits; *ethos* is the dwelling of being; it is the space where moral subjectivities are built, so that they can build a 'good' society (Melina).

The family dimension

Any ‘robust definition of human well-being’ (Oakley) is a relational definition. The human being, called into existence by a gift of life and a gift of word, is structurally capable of love and solidarity (Salmeri). It is a ‘good’ personal experience that can support a ‘good’ public life, that provides the reciprocal trust without which society cannot survive. Hence, it is of the utmost importance to re-affirm the ‘public’ role of the family (Melina). This requires rehabilitate the family as producer and redistributing agency, as it has been for centuries: state and market appropriating of the roles of production and distribution led to indebtedness. The same financial issue of pensions (besides reducing the obsession with the financial side of them, as suggested by Dembinski) can be more effectively addressed in family-oriented policy making.

Finance is ethical when it is true to its nature (CV 45)

During the Consultation, there was an overarching effort at rethinking the nature of finance and the nature of markets. The issues is much broader that considering ‘ethical finance’ defined as a specific niche, and ethical issues in finance go way beyond ethical dilemmas usually discussed by finance professionals, which seem to be centred mostly on matters like moral hazard and agency problems – overlooking the huge transfers of wealth to the financial sector at the systemic level, both from the real economy and from the poor and middle class (Garvey)

So-called markets often do not deserve the name (they are not true to their nature). A market is essentially a meeting of human persons: rules do matter, but also the actual priorities of participants. In a well-functioning market, information is available to all participants and all are put on the same footing; that is, market should be as open and organized as possible, so to function as a collective tool for discovering ‘true’ prices. Hence, participants should elaborate an ethical vision, to contribute to elaborating such prices and not taking short-run advantage of possible bubbles; finally, they should be (also legally) responsible of their acts. (De Lauzun)

That is to say, righteousness (virtue) is a necessary ingredient - beyond merely formal organization and regulation – for the market to be true to its nature, that is a space for human relationships where interest can be experienced as i*nter-esse*. Financial markets, in particular, can become the space where human relationships are built, transforming the same object of the market from ‘merchandising time’ to building intertemporal alliances, building a ‘re-connected’ finance. Re-connecting finance is efficient, as ‘the packaging, selling and reselling credit relations implied the losing (or ignoring) of precious information associated to credit underwriting’ (Bonnici). ‘Getting rid of the illusion that finance can eliminate risks from the real economy’ (Dembinski) is simply a matter of realism.

With respect to responsible business and corporate social responsibility, dealt with in par. 4, on “lessons learnt”, two ethically relevant issues can be raised. First, how do exemplar business experiences spread? And how can they be communicated? (Sugranyes). A second issue points to the possibility that the evident emerging role of large businesses, holding relevant monopoly power, may bring a shift from the recent unregulated form of ‘privatized Keynesianism’ to a sort of ‘self-regulated privatized Keynesianism’, where businesses are key for the achievement of policy goals and preserving capitalism. (Crouch, reference by Coffman). In this perspective, one should be aware of the existence of a possible ‘dark side’ in corporate social responsibility practices, when they become instrumental to reinforcing market power. Business and political ethics is not a label, as issues of meaning, humanization, virtues, and responsibility remain as a permanent challenge to human freedom, especially the freedom of those who bear vast economic and political responsibilities. 'Good' business and 'good' politics, for the good of the 'all-of-us', call for integral 'good life'.

Is there a role of the Church in bringing financial reform?

The primary role of the Church is an educational role. The effective incidence of the Church is in being 'teacher of Jesus', reaffirming the primacy to God over the economy and over profits (Toso); speaking to the person, so to 'reform global finance, one banker at a time' (Fieler). The Church's calling for social justice and the common good is not an attempt to impose state-rule on society, but rather a call to personal spirituality, to resist privatization of family life, to assess the relational nature of the human person. This approach needs to include, at the same time, a realistic highlight of who bears more responsibility in conducting the economy and in policy making (Toso). In the Church's mission, there is an irreplaceable role for lay apostolate, 'always fighting' (Sturzo, reference by Diotallevi)

The social doctrine of the Church is knowledge illuminated by faith, in friendly dialogue with all branches of knowledge: hence, in the Catholic tradition, we are called to engage the full breadth of reason "by placing the dignity of the person at the intersection of two axes: one horizontal, representing "solidarity" and "subsidiarity", and one vertical, representing the "common good"." (Benedict XVI, reference by in Scola FCA 2012). The language of catholic social doctrine needs to be familiar to politicians, civil society, leaders; this also call for 'translating' that language in terms more accessible to bankers and financial agents (Estanislao).

Christian theology can bring two things to a discussion on an ethical economic future. One, challenging the self-referential tendency of economic discussion and bring it back where it belongs, namely a rational discussion on human purpose and motivation; second, awakening and sustaining the desire for integrity in human life, including the economy and finance. God gives us our being, our response is our becoming: Adam, where are you? Who have you become? (Oakley)