**Ethics in Economics – Lessons and Themes for Further Development in the Vatican’s 2018 Letter**

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**ABSTRACT**

Since the financial crisis, there has been much discussion about the importance of ethics in economic life. An important contribution to this discussion was a 2018 Vatican letter on the financial system which reiterated and further developed Catholic social teaching. This article argues that the Catholic Church is correct to integrate ethical considerations into the consideration of economic matters as well as to recommend an inter-disciplinary approach to this endeavour. However, the article proposes that, Catholic social teaching in this field should focus more on the importance and development of the virtues. This would help the Church make a unique contribution to debates on particular practices in financial markets and to the development of programmes relating to education and culture. Furthermore, the Church’s understanding of the human person can help us make discerning judgements about the place of regulation in economic life.

**INTRODUCTION**

The 2018 Vatican letter, *Considerations for an ethical discernment regarding some aspects of the present economic-financial system*’[[1]](#footnote-1), examined the relationship between ethics and economics in the context of contemporary issues in finance. It was a contribution to reflection that has been taking place since the financial crisis. It also marked a continuation of the development of Catholic social teaching and thought in this area. For example, it built on papal encyclicals *Caritas in Veritate* (2009), *Rerum Novarum* (1891)*, Quadragesimo Anno* (1931) and *Centesimus Annus* (1991) as well as on Pontifical Council for Justice and Peace (2005)[[2]](#footnote-2), especially 270-374, the work of the late Scholastics (see Alves and Moreira, 2013) and St. Thomas Aquinas.

The relationship between ethics, business, finance and economic life in general was an important theme of the letter. It was stated, for example, that ethical practice must begin with a personal choice between right and wrong:

It must be noted that the systems that give life to the markets…are in fact founded on relationships that involve the freedom of individual human beings. It is evident therefore that the economy, like every other sphere of human action, ‘needs ethics in order to function correctly — not any ethics whatsoever, but an ethics which is people-centred’ (8).

The letter then further notes (23) that freedom ought to be oriented towards the good and the true if the common good is to be promoted. Importantly, it points out (especially 8-11) that economic activity has a relational character: it is not just about goods and services being exchanged. This provides a further justification for not separating economics from ethics.

Despite references to the importance of ethics and education, it is notable that the treatment of virtue ethics in the letter was very limited. Furthermore, a series of issues were raised in the Vatican’s letter which we should see through a different light when we accept the importance of the virtues. A full and explicit consideration of the practice of the virtues would have helped to unify various aspects of the message and also provide a solid basis for thinking about the design of programmes of education that might change culture.

This paper explores these themes in greater depth. Taking the Vatican’s letter as the starting point for dialogue rather than as the last word, we begin by exploring the importance of the practice of ethics and the virtues in economic life. If the virtues are seen as important, the dynamic of debates about practice within financial markets, education, culture and regulation change. The paper then moves on to examine some of the particular practices in financial markets that are discussed in the Vatican letter. Different conclusions are reached from those in the letter about the appropriateness of those practices as we can see them in a different context if we consider the potential to improve rather than just restrain and prohibit behaviours. This then leads to important observations about education and culture. Finally, the paper discusses regulation. When it comes to regulation, a Christian anthropology of the human person can help us understand the limits of regulation as well as the diverse sources of different forms of regulation.

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

**ETHICS AND VIRTUE IN ECONOMIC LIFE**

It is widely perceived that the current pope in particular and Catholic social teaching in general is hostile to business and finance[[3]](#footnote-3). This is not the case. Catholic social teaching tends to welcome business and finance whilst highlighting the need for ethical behaviour in economic life so that business serves society. The need for ethics in economic life was put succinctly by Pope Benedict XVI in *Caritas in Veritate*, (36):

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.

Many schools of economics have tended to separate economics teaching from ethics. For example, Keynesian schools have encouraged a focus on aggregate variables rather than on personal action[[4]](#footnote-4). The Chicago school has tended to narrow the focus of economics to non-ethical questions, though it has pioneered the study of crime, the family and so on, but through an empirical lens. An aspect of this tendency has been the trend for economic modelling to become more abstract and mathematical.[[5]](#footnote-5) However, Professor Lord Robbins, who was one of the greatest historians of economic thought of the 20th century, *did* stress that economics involved the study of human behaviour. Specifically, in Robbins (1932), he defined economics as: "the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses". Robbins’ definition, which is widely used in high school and undergraduate economics courses, immediately raises questions about ethics[[6]](#footnote-6).

At a basic level, we can say that, where “human” and “action” or “behaviour” appear in the same sentence, ethics are likely to be important. As Pope Benedict put it in *Caritas in Veritate: “every economic decision has a moral consequence” (CV 37,* italics in original*).* If we attempt to teach economics without ethics, one would be limited to teaching “technique” and thus perhaps ignoring the most important aspects of economic action.

Economic action involves the choice of ends. For example, business owners may choose between maximising owner-value measured in financial terms without reference to any other considerations, such as how vulnerable members of the workforce are treated, or they may choose to pursue a broader set of ends. This is a decision about chosen ends about which ethics has something to say.[[7]](#footnote-7)

The choice of means should also involve ethical discernment. A particular business might have a perfectly satisfactory chosen set of ends, such as making a profit whilst treating its employees justly, but choose means to meet those ends that are morally problematic such as selling pornography. On the other hand, another business with the same ends, might choose to meet those ends by selling alcohol or operating in the financial sector. These are activities that are not intrinsically immoral but which could be in certain circumstances (for example, if marketing of alcoholic products of an especially addictive type were aimed at young people).

Further ethical dimensions are revealed when we consider the *intent* of actions in the economic sphere. To take a specific example to which the Vatican’s 2018 letter referred, if by creating complex securitisation products in financial markets we intend to provide cheaper mortgages for families, that would not seem to be morally problematic even if some people did not understand the product and, as a result, made some minor financial loss[[8]](#footnote-8). If, instead, our intention is to create a product that others do not understand and thereby make money from selling it knowing that large numbers or people would make large losses, that would be morally problematic. As the Vatican letter states (17): “What is morally unacceptable is not simply to profit, but rather to avail oneself of an inequality for one’s own advantage, in order to create enormous profits that are damaging to others”. The words “in order to” imply an intent to make profits at the expense of others.

These basic questions of ethics in economic life to do with ends, means and intent are important issues for those operating in the business sector. In some cases, there will not be straightforward answers to questions relating to ethics in economic life and the integration of technical knowledge and human wisdom is important in making judgements as is noted in the first paragraph of the Vatican’s 2018 letter.

Economists do not entirely ignore ethical issues, but they tend to treat them in an empirical rather than in a normative framework[[9]](#footnote-9). Such an approach might be regarded as a reasonable division of labour between the economist and the ethicist, though Yuengert (2004) questions this. One example of an economist considering the practical effects of ethics is given by Nobel Prize winner Kenneth Arrow (Arrow, 1972). He said: “Virtually every commercial transaction has within itself an element of trust…It can be plausibly argued that much of the economic backwardness in the world can be explained by the lack of mutual confidence.” Interestingly, considering the problem from the perspective of a theologian, Pope Benedict made a remarkably similar comment in *Caritas in Veritate* (17) in which he said: *“Without internal forms of solidarity and mutual trust, the market cannot completely fulfil its proper economic function”* (emphasis in original). This juxtaposition highlights the importance of an inter-disciplinary approach to education. Ethical discernment can make use of empirical observation. At the same time, it is important in the context of Christian education to have a stronger basis for making ethical judgements than simply an understanding of empirical consequences of actions.

In the Catholic tradition, this formational aspect of developing the ethical person is often rooted in a nurturing of the virtues. It is puzzling that there is no reference to virtues in the Vatican letter at all given that the practice of the virtues is a crucial aspect of promoting ethical choices in the economy in general and in financial markets in particular. The letter contrasts with *Rerum Novarum*, in which the word “virtue” appears 15 times and also with the interventions of Cardinal Vincent Nichols after the financial crisis who frequently stressed the importance of practising the virtues in finance and business life (see, for example his introduction to Booth (ed) (2010) as well as Bishops’ Conference of England and Wales (2010), published before the UK general election of that year).

The relational aspect of economic activity immediately signals the need for the practice of virtues such as temperance[[10]](#footnote-10). If practised, this virtue would lead people to behave in the economic sphere with restraint, humility, and modesty; to practise forgiveness and be careful not to retaliate and bear grudges; and to not believe that somebody else doing something wrong justifies their doing something wrong.

Arrow’s comment on trust and economic outcomes has been mentioned above. It is worth noting that the mottos of both the London Stock Exchange and the Baltic Exchange in the UK have been, for a long time, “my word is my bond”. The specific virtue that is needed to ensure that trust is paramount in dealings in financial markets is that of justice which ensures that all obtain what is due to them[[11]](#footnote-11). If participants in financial markets act justly then trust can be built. The importance of trust in financial markets is also illustrated by the fact that the word “credit” is derived from the middle French, Italian and Latin word for trust, again as noted by Cardinal Nichols in his many interventions following the financial crisis.

A focus on the importance of the virtues allows us to develop further three themes of the letter which are considered in the sections below.

**MAKING JUDGEMENTS ABOUT PARTICULAR PRACTICES**

The ability to choose between right and wrong behaviours and to practice the virtues in economic life so that we are able to act as better people allows us to think in a more nuanced way about particular practices in financial markets which might otherwise simply be dismissed. This is the particular point which Pope Benedict is making in number 36 of *Caritas in Veritate* quoted above*.*

Practices in finance have come under scrutiny from ethicists for centuries. Since the financial crisis, attacks on the financial sector and practices within it have intensified and have come from a variety of perspectives. In the last ten years, there have been many examples of sustained criticism of the financial sector from academia, professional life and different religious groups. To give one example, Lord Turner, Chairman of the then UK financial regulator (the Financial Services Authority) from 2008-2013, claimed that much activity in the financial sector was ‘socially useless’. His report, Turner (2009), mentioned a number of the concerns that were also raised in the Vatican’s 2018 letter[[12]](#footnote-12).

One of the reasons why the financial sector comes under attack is that the purposes of financial institutions are difficult to understand because their products are not tangible. The sector makes possible forms of economic activity that would not otherwise be possible. For example, without banking[[13]](#footnote-13), all economic exchange would have to be facilitated through barter or a commodity money such as gold. The financial sector provides households with a secure place to save in a way which reduces risks and the costs of assessing potential borrowers whilst simultaneously ensuring that individuals and businesses can borrow to buy houses, finance business operations, and so on. Furthermore, the financial system allows business to borrow over a long time period whilst households that save can access their capital instantly. Without these functions being performed efficiently, much real economic activity would be impossible. Given this, perhaps it was not surprising that the Vatican’s 2018 letter suggested that: “Here financial activity exhibits its primary vocation of service to the real economy” (16).

However, the financial sector does not just exist to serve the real economy. Without a thriving financial sector only the very wealthy or those who had strong family ties would be able to retire. The financial sector allows people to invest in a diversified range of companies, reducing the transactions costs of analysing those companies for creditworthiness and their long-term ability to thrive, thus facilitating pensions saving and retirement. Without insurance, people would live in fear of their home being destroyed: insurance companies pool risks, thus benefiting people on ordinary incomes who could not afford the financial catastrophe that arises from insurable events. So, the financial sector has intrinsic functions, not just instrumental ones.

The social usefulness of practices within financial markets is not always immediately apparent. Judgements about such activities require careful discernment.

There are many examples of such activities given and critiqued and often criticised in the Vatican’s 2018 letter. One such issue mentioned that was mentioned was high frequency trading (though with no elaboration) and another was financial speculation (17):

Such a practice is particularly deplorable from the moral point of view when the intention of profit by a few through the risk of speculation even in important funds of investment, provokes artificial reduction of the prices of public debt securities, without regard to the negative impact or to the worsening of the economic situation of entire nations.

The practice of speculation has been widely discussed in the development of Catholic social thought. Perhaps the most authoritative reference on speculation and moral theology in mediaeval times is Baldwin (1959) who argued that speculation is morally problematic whilst it should not be illegal. Nakrosis (2013) examines objections to speculation in moral theology as discussed by Nell-Breuning[[14]](#footnote-14). Nakrosis’ concludes that speculation can have economically valuable effects and, in those cases, it should not be assumed to be morally wrong. Nell-Breuning himself did not come out firmly against speculation, but he did suggest that proximity to it could tempt people into sin. Johannes Messner’s position was not dissimilar to this and the way the Catechism (2409)[[15]](#footnote-15) defines sinful speculation implies that there is such a thing as licit speculation[[16]](#footnote-16).

In fact, the letter does not say that speculation is always and everywhere wrong, though it can be argued that the letter leaves the reader with that impression. Proponents of speculation would argue that it has benefits. For example, in markets such as those for food, it can bring forward production of the physical commodity at times of shortage and can also reduce price fluctuations in markets. Speculation can provide liquidity in markets and so reduce price fluctuations.

Of course, there are critiques of speculation too, including within the academic economics literature. For example, Nobel Prize winning economist Robert Shiller (2017)[[17]](#footnote-17) describes common-place critical discussions of speculation in the US in the 1920s and 1930s.

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

The letter also mentions high interest rates being charged to borrowers (16) and the use of offshore financial centres (30 and 31). In the former case, it is not suggested that interest should not be charged at all, and most modern interpretations of usury would not argue that the charging of interest on loans should be prohibited (e.g., see Gregg, 2016, chapter 3). The relative ethical merits of different forms of contract and different levels of interest rate again require discernment.

The phenomenon of debt securitisation also comes under scrutiny (26). This has been widely discussed since the financial crisis in a number of forums. In a Catholic social teaching context, for example, the issue was raised by Cowley in Booth ed, (2010) in an early contribution by Catholic thinkers following the financial crisis. Again, it cannot be said that securitisation is intrinsically morally problematic. If the concern is complexity, there is no logical stopping point where we can say “this is too complex: it should be prohibited” or, indeed, “this is too complex: it is unethical”. Mortgage securitisation, which is often blamed for the financial crisis, was widely welcomed by central bankers and regulators as well as by people in financial markets. Indeed, Paul Tucker, the director in charge of financial stability at the Bank of England speaking just before the crash said: “So it would seem that there is a good deal to welcome in the greater dispersion of risk made possible by modern instruments, markets and institutions” (Tucker, 2007). If the intention of those creating such securities was to lower funding costs for investors and help disperse risk (thus benefiting their own firm, households and all those who relied on the stability of the banking system) then it is difficult to argue that their creation was immoral.

There are a number of practices brought up in the letter, including those mentioned above, that are not in themselves objectively unethical but which may have undesirable consequences in certain circumstances[[18]](#footnote-18). This is true, of course, in any area of human activity. The tone of the letter is implicitly critical. Certainly, these areas of finance might provide occasion for sin and lead to temptation. However, it is reasonable to ask whether the focus in the letter was on the activities to too great a degree*,* rather than on providing practical advice and instruction about how to make ethical choices when faced with temptation in financial markets. Decisions in relation to such practices require the application of the virtues. In particular, temperance is important so that those in financial markets have the correct disposition when developing and marketing such products and practices. Justice is important for ensuring that both parties to a transaction are treated fairly and one side does not take unfair advantage of the other. Prudence is also required so that the impacts of behaviours and practices are clearly thought through. Of course, there will always be unforeseen consequences (see below): prudence will not lead to perfection. A deeper discussion of virtue ethics might have led to such connections being made allowing the letter to make a distinct contribution to discussion about these questions.

If we accept that particular activities in financial markets are not intrinsically wrong but may be so in certain circumstances, then the importance of education in the virtues comes to prominence as does the question of culture. These are questions to which we turn in the next section.

**EDUCATION, CULTURE AND THE VIRTUES IN ECONOMIC LIFE**

Recognition of the range of activities within financial markets that are not intrinsically unethical, but which might be potential occasions of sin, leads us back to the question of how we can make judgements in these situations. The importance of formation in the virtues arises again. Whilst some activities in financial markets may be regarded as intrinsically bad or of no social use, the fact that it is so difficult to draw that line and the fact that some activities may be problematic only in particular contexts calls for the exercise of the virtues.

According to a Thomistic way of thinking, the human person can judge matters of right and wrong through the employment of reason based on the primary precepts of natural law which can be understood with great certainty. However, practical decision-making requires more nuanced ethical judgements with the particular circumstances of time, place and intent being important. This is not a matter of situation ethics or consequentialism. The ethical principles remain the same, but their application may lead to different actions in different contexts.

To take a particular example, the Vatican’s letter mentions the problem of “information asymmetries”[[19]](#footnote-19) (14). Using that example, the letter says that there are certain “methods” which are not always unethical, but which might be so in particular circumstances. It goes on to say: “What is morally unacceptable is not simply to profit, but rather to avail oneself of an inequality for one’s own advantage, in order to create enormous profits that are damaging to others; or to exploit one’s dominant position in order to profit by unjustly disadvantaging others, or to make oneself rich through harming and disrupting the collective common good.” (17) St. Thomas Aquinas, in *Summa Theologica*, II-II, Q 77, Art 2, 3 dealt specifically with what we have now come to know as “information asymmetries” and how their exploitation may be unethical in some contexts and not others using the practical examples of horses and coinage. The late Scholastics also dealt with a number of further examples (see Alves and Moreira, 2013).

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

The necessary formation can come through education, both formal and informal. Here the Vatican letter thrust upon educational institutions an important responsibility when they were exhorted as follows:

it is particularly desirable that institutions such as universities and business schools both foresee and provide…a formational dimension that educates the students to understand economics and finance in the light of a vision of the totality of the human person…An ethics is needed to design such formation. (10)

But, in order to create the right culture according to Catholic social teaching, it is not just technical education nor education in ethics in general that is important. Furthermore, the appropriate education cannot simply start in professional life. Formation must be in a virtue ethics approach and start from the very beginning of education. *The Catholic School on the Threshold of the Third Millennium* was highly critical of education that was reduced to technical aspects and which ignored ethical formation (see especially 6 and 10). *Familiaris Consortio* stresses the role of the family in education, especially in the virtues:

“The family has vital and organic links with society, since it is its foundation and nourishes it continually through its role of service to life: it is from the family that citizens come to birth and it is within the family that they find the first school of the social virtues that are the animating principle of the existence and development of society itself.” (42).

This is also stressed in the Second Vatican Council document, *Gravissimum Educationis*: “the family is the first school of the social virtues that every society needs” (3). From a Christian perspective, formation in the virtues and an ethical way of thinking through early education in the home and at other places of education is therefore an important first step and should then be a continuing process through university and executive education. Whilst, of course, it is better if universities, professions and companies themselves help educate and train individuals in the practice of the virtues applied to concrete situations in the world of finance and economics, this is likely to be more effective if education and the practice of the virtues has started at a younger age. As the Catechism of the Catholic Church puts it: “Human virtues acquired by education, by deliberate acts and by a perseverance ever-renewed in repeated efforts” (1810).

In financial markets, as noted above, the virtue of prudence[[20]](#footnote-20) is especially important. There may be long chains of cause and effect between chosen means and desired or unintended ends and consequences. Operating with wisdom (see paragraph 1 of the Vatican’s 2018 letter) and in a way that is well informed, especially about the impacts on those to whom we owe special duties, is important. In addition, the virtue courage is also crucial. The amount of money tied up in the described activities and the difficulties for businesses when changing course away from a particular business plan mean that it can be difficult to act in an appropriate ethical manner either as an individual or in terms of setting corporate strategies. In this context, “speaking truth to power”, whistle-blowing and even resigning one’s own position can be courageous acts of virtue in the face of temptation. Again, these are virtues that can be nurtured (or undermined) by culture and developed in higher education and continuing professional development and other forms of education within the business sector. Because prudence requires careful reasoning in the full knowledge of the facts, education in the technical aspects of the activities described, their benefits and their wider (perhaps problematic) impacts is important as well as education in the virtues. The letter is right to stress an inter-disciplinary approach.

The right kind of education can help promote the right culture in economic life and in financial markets in particular. The creation of an ethical culture relies on education and formation, but it is also part of the wider social responsibilities of businesses as discussed in Alves et al (2019). The market can interact with the broader cultural sphere through professional associations and societies, unions and a variety of other bodies (see Charles, 1998, pages 392-394). But culture is important in economic life itself: the economic and cultural sectors are not separate. And the economy is not simply made up of atomised individuals whose decisions do not affect the decisions of others. Culture can have an important impact on how we behave. A degraded culture does not turn wrong actions into right actions, but it may make it harder to do what is good and reduce the culpability of those behaving unethically[[21]](#footnote-21).

The Vatican letter does allude to this issue, pointing out:

Every business creates an important network of relations and in its unique way represents a true intermediate social body with a proper culture and practices. Such culture and practices, while determining the internal organization of the enterprise, influence also the social fabric in which it operates. (23)

But this was just a passing mention rather than a sustained analysis. It was mentioned in *Caritas in Veritate* that the relationship between the market and the moral-cultural sphere has not always been as explicit in recent Catholic social teaching as it could have been and the 2018 letter did not really take the subject further. Given that economic action is a subset of human action more generally, the formation of culture and the impact of culture on decision-making are important. Again, the education sector can assist with the development of an ethical business culture, not just by teaching about ethics and virtues in general, but by applying the ideas to realistic case studies to better prepare people for business life. This is especially true at university level and in professional development.

**THE VATICAN LETTER AND STATUTORY REGULATION – THE NEED TO DEVELOP THE POLITICAL ECONOMY FRAMEWORK**

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

At the same time, it is clear that markets, as powerful propellers of the economy, are not capable of governing themselves. In fact, the markets know neither how to make the assumptions that allow their smooth running (social coexistence, honesty, trust, safety and security, laws, and so on) nor how to correct those effects and forces that are harmful to human society (inequality, asymmetries, environmental damage, social insecurity, and fraud). (13)

This is a strange way of anthropomorphising markets. Markets operate within a human-created institutional structure and involve exchange between human persons in an extended economic order. Markets are not capable of “knowing” anything. However, individuals involved with market exchange are capable of knowing and controlling their behaviour. As noted in *Caritas in Veritate,* things can go wrong in markets because of human error and sinfulness as has been discussed above. But human persons can choose another path too. This is precisely why economics and ethics should be linked. “Markets” are not capable of choosing any more than a “farm” is capable of choosing whether to use cruel techniques to husband animals. Markets and farms are both abstractions.

Given that markets can fail because people can fail, regulation by the state might be proposed to promote the common good. *Caritas in Veritate,* for example, stated (21): “regulation is made even more necessary in view of the fact that among the major reasons for the most recent economic crisis was the immoral behavior of agents in the financial world”. This message was echoed in the Vatican’s 2018 letter (especially 21).

There is a problem, however, with this line of reasoning. It may be the case that prudent consideration leads us to believe that government regulation can help promote the common good. However, to assume so automatically would appear to presuppose a degree of perfection amongst those taking decisions in relation to regulation that cannot be found either amongst market participants *or* amongst those taking decisions in government regulatory bureaus.

As a result of human imperfection, instead of regulation being developed for the general public interest, it can be shaped by private interests. Without using regulation as a specific example, Catholic social teaching has warned about the use of the political system to pursue private interests (Pontifical Council for Justice and Peace, 2005, 565-574) and Pope Francis has warned about the relationship between business groups and the state (*Laudato Si,* 197). The problem of regulation becoming shaped by private interests is one of the areas of research for which James Buchanan won his Nobel Prize in 1986 and is explored in the discipline of public choice economics.[[22]](#footnote-22) This is an area of economics typically associated with free-market economists, but Stiglitz (2010) and Marquand (2014) have also mentioned the problem of private interests shaping regulation coming from a left-leaning perspective. These private interests might be regulators themselves, politicians or the regulated industries which may try to capture regulatory processes for their own benefit.

In addition, politicians and regulators may have cognitive biases that lead them to over-estimate the efficacy of government regulation: they are not neutral arbiters. Furthermore, regulators may not be able to predict with confidence the impact of their actions and regulation may even lead to the opposite of the intended effects. We may have what are often described as “unintended consequences”. Sometimes these arise because of “second-round” effects which are not obvious from a superficial analysis of the likely impact of regulation (“known unknowns”). Sometimes unintended consequences may relate to factors that no reasonable prudent analysis could possibly have uncovered (“unknown unknowns”). The chapter by Booth and Davies in Coyne and Coyne (ed) (2015) explains the unintended consequences of price controls, including interest rate controls, in financial markets. Interestingly, in the seventeenth century, Locke wrote about interest-rate controls in financial markets in an example that is often cited as the origin of the idea of unintended consequences. It could be argued that the case St. Thomas Aquinas made for the toleration of prostitution was based, at least partly, on a concern for the unforeseen consequences of prohibition.

One does not have to go far to find interventions by government institutions that demonstrate this problem in the case of the financial crisis. To give one example, in the run-up to the financial crisis, there were regulatory moves that encouraged banks to invest in mortgage-backed securities that many believed were at the seat of the crash (see, for example, Gerding, 2015, pages 18-20). Mortgage-backed securities were also encouraged by government guarantees. As has been noted above, even just before the crash, a senior Bank of England official suggested that mortgage-backed securities would disperse risk in the financial system.

The point here is not to excuse those responsible who worked within banks in the 2000s. The problem is that many actions taken by regulatory authorities or central banks made the financial crash either no less likely or made it more likely and its effects worse. Those who regulated banks share our human imperfection. This should be the anthropological starting point for the analysis of statutory regulation as a solution to problems within financial markets.

These sections of the Vatican’s letter on regulation justify the letter’s call for an inter-disciplinary approach to developing a genuinely deep understanding of economics. This was a consistent theme of Hayek (see Caldwell, 2004, page 339). A combination of different strands of economics and political economy, combined with an understanding of Christian anthropology of the human person and the practicalities of the financial system, is important if prudent and wise decisions are to be taken about the role and limitations of statutory regulation. It can be argued that the consideration of economics alongside the nature of the human person came through the work of Adam Smith, especially if the *Theory of Moral Sentiments* (Adam Smith, 1759) is considered together with *The Wealth of Nations* (Adam Smith, 1776)*.* Since the financial crisis, others have tried to revive this tradition[[23]](#footnote-23), but it is still largely absent from the study of modern economics and, despite the message of paragraph 1, was not obviously a theme of the letter. Possibly as a result, the section relating to statutory regulation lacked subtlety and a distinct Christian perspective.

It is important to add that the virtues are needed in this area of regulation too. Prudence may help us understand unforeseen consequences or, at least, make us aware of their existence. And temperance and justice should help us not to seek or use regulatory powers to further our own interests. These fundamental human characteristics of the limitations of human knowledge and the potential for selfishness to be exhibited in the political process help us understand that there are limits to the efficacy government regulation – and also that there is some doubt about where those limits may lie. Indeed, the long history of Catholic social teaching has criticised both an over bearing state and unbridled markets[[24]](#footnote-24). The principle of subsidiarity in Catholic social teaching can help us respond to these problems and, in particular, help us understand how markets can be restrained by a range of social institutions.

**Subsidiarity in financial regulation**

When considering the question of the regulation of economic life, Catholic social teaching has a long history of emphasising the importance of civil society institutions in regulating the economy[[25]](#footnote-25). This is important given the potential shortcomings of government regulation in dealing with many of the problems that are perceived to exist in financial markets. Although the recent Vatican letter (quoting an earlier Vatican letter on the financial crisis) suggested that deregulation leads to a regulatory and institutional vacuum (21), it went on to say, in apparent contradiction:

Numerous associations emerging from civil society represent in this sense a reservoir of consciousness, and social responsibility, of which we cannot do without. Today as never before we are all called, as sentinels, to watch over genuine life and to make ourselves catalysts of a new social behavior, shaping our actions to the search for the common good, and establishing it on the sound principles of solidarity and subsidiarity.

The tradition of regulatory institutions developing within financial markets was otherwise neglected in the Vatican’s 2018 letter. There are numerous examples of such institutions regulating financial markets with great effect (see especially, Stringham, 2015).

Perhaps the most notable example is that of stock exchanges. Until 1986 in the UK, and in earlier times in other countries, exchanges were entirely market-generated regulatory bodies which regulated markets strictly. Indeed, the regulation of the London stock exchange was so tight that its powers were curtailed by the government in 1986 because the government believed the exchange’s regulatory powers were used to effectively create a cartel (see Booth, 2014). The London stock exchange, like others, was essentially a club or society which could determine its own rules for membership and for the behaviour of its members.

Stock exchanges are not the only examples of private rule-making institutions in financial markets. Professional bodies blossomed in mid-to-late nineteenth century financial markets: interestingly, their importance is mentioned in Catholic Church teaching in other contexts in documents such as *Centesimus Annus* and *Quadragesimo Anno,* though they were not mentioned in the letter. In the US from 1875 to 1930 there was very little regulation of accounting. Indeed, publicly quoted firms did not have to be audited, though many were. By 1926, 90 per cent of companies quoted on the New York Stock Exchange had audited accounts and there were professional bodies of accountants with their own rules who were responsible for auditing in many cases.

Such regulatory institutions are continually developing in new contexts, a modern example being the International Swaps and Derivatives Association (ISDA). ISDA’s mission is: “[to foster] safe and efficient derivatives markets to facilitate effective risk management for all users of derivative products.” It achieves this in a number of ways all of which involve regulatory functions, such as: “Developing standardized documentation globally to promote legal certainty and maximum risk reduction.” Members have to apply to join and can have their membership revoked.

Thus, it could be argued that the principle of subsidiarity, and how it might apply to regulation, especially involving market-based and civil society organisations, is another under-explored topic in the letter. These institutions are also especially important because of their link with culture. Professional bodies, in particular, are themselves educating bodies in their own right. They not only provide education in technical aspects for their members but can, and should, provide education on ethical conduct in professional life.

By recognising the potential role of civil society institutions in the promotion of culture and the development of regulation, the Church would not only be applying the principle of subsidiarity in a field in which there is a rich historical tradition in practice, it would also be recognising, consistent with the social teaching tradition, that the promotion of the common good in this area is the responsibility of all institutions in society. Furthermore, it would be directly attacking and proposing solutions to the problem of the “state-individual nexus” that pervades so much public policy debate and that is incompatible with Catholic social teaching, as noted in *Caritas in Veritate* (39): “The exclusively binary model of market-plus-State is corrosive of society”.

**CONCLUSION**

The 2018 Vatican letter *Considerations for an ethical discernment regarding some aspects of the present economic-financial system* contained important reflections on ethical behaviour in economic life with particular emphasis on the financial system. In this respect it reinforced and expanded upon earlier teaching of the Catholic Church.

Although many economists would argue that it is reasonable for them to examine technical or empirical economic questions without considering wider ethical issues, given that economics involves the study of human behaviour the relationship between economics and ethics cannot be ignored. As such, it is appropriate that the disciplines are unified, not just in Catholic social teaching, but in academic research and teaching more generally. In economic life, persons have to choose ends and means and such choices require ethical discernment. It was important for the Vatican letter to stress this. However, the letter did not stress the importance of the virtues which, in Catholic social thought, should be regarded as the key to ethical decision making in complex and challenging circumstances. Virtues such as courage, prudence, justice and temperance need to be practised if financial markets are to serve society effectively.

Deeper consideration of the virtues helps us understand the context in which particular practices in financial markets might or might not be unethical or might or might not promote the common good. There has been significant discussion of these issues in the tradition of Catholic social thought. The 2018 letter could have treated these questions of practice in financial markets more systematically if it had contained a sustained discussion of the importance of the virtues in forming ethical behaviour in financial markets.

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

The Vatican letter proposed various forms of regulation to promote the common good within financial markets with the focus being on statutory or government regulation. Such regulation may be justified. However, an inter-disciplinary approach to the subject, which combines insights from economics and political economy, combined with a Catholic understanding of the nature of the human person, should help us appreciate the limits of statutory regulation in this field. Furthermore, a study of the history of financial markets, as well as of Catholic social teaching in other areas, may lead us to be pre-disposed towards regulatory institutions that arise within markets and civil society. This is not to deny the need for state regulation, and the justification for statutory regulation of economic life in modern Catholic social teaching is certainly valid. However, there are other sources of regulation of markets which are congruent with the principle of subsidiarity and the tradition of Catholic social teaching more generally.

Underscoring all the themes discussed in this article is the observation that our understanding of these issues changes as we focus on the importance of people striving for the good when acting in the economic sphere rather than striving for the single goal of personal enrichment. In relation to the regulatory framework for economic life, Vincent Nichols, in Bishops Conference of England and Wales (2010) wrote: “In place of virtue we have seen an expansion of regulation. A society that is held together just by compliance to rules is inherently fragile, open to further abuses which will be met by a further expansion of regulation. This cannot be enough. The virtues are not about what one is allowed to do but who one is formed to be.” The virtues can help us understand the context in which different practices in financial markets might be right or wrong; inform programmes of education that combine technical knowledge with virtue ethics applied to business life; and help us see some of the shortcomings of regulatory responses to problems in financial markets.

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1. This is a long title in the English language version and it will be described below as the “Vatican’s 2018 letter” or “The Vatican’s 2018 letter on the financial system” or simply “the letter”. [↑](#footnote-ref-1)
2. That is *The Compendium of the Social Doctrine of the Church.* [↑](#footnote-ref-2)
3. With regard to Catholic social teaching in general see, for example, Woods (2005) page 1 and the essay ‘Ecclesiastical Economics: Envy Legitimized’ in Bauer (2000). [↑](#footnote-ref-3)
4. This is not true of Keynes himself. [↑](#footnote-ref-4)
5. A trend which has been criticised by many, including the Post-Crash Economics Society at the University of Manchester which has had the support of a number of prominent economists. [↑](#footnote-ref-5)
6. There is an excellent discussion of economic technique and its relationship with ethical reasoning in Yuengert (2004). [↑](#footnote-ref-6)
7. It is important to note, and, once again, Yuengert is excellent on this point, that it is necessary to follow through this reasoning to consider ultimate ends and ultimate decision makers. For example, money is rarely an end in itself – it is the goods that are bought that are ends (except for a miser). At the same time, the business owners might maximise financial owner-value in order to give away the money to development projects and so the owner might not be maximising the financial value of the business for his own ends. [↑](#footnote-ref-7)
8. I have described a situation where the intention is good and there are some unfortunate by-products of the action. The intention might be good, but the outcome terrible. In this case, acting with prudence should make people think twice before marketing such a product. [↑](#footnote-ref-8)
9. As well as Yuengert, an excellent reference on this subject is Hirschfeld (2018). [↑](#footnote-ref-9)
10. Also courage and prudence as will be discussed later, but these are perhaps more important in a different context. [↑](#footnote-ref-10)
11. “What is due to them” does not mean simply what is due to them according to written contracts, it can also relate to verbal agreements and implicit agreements (i.e. what two parties really expect when they enter into contracts). [↑](#footnote-ref-11)
12. For example, securitisation (Turner, 2009 section one and Vatican letter 26), global regulation of financial markets (Turner, 2009 section 2 and Vatican letter 21) and credit derivatives (Turner, 2009 section 2 and Vatican letter 26). [↑](#footnote-ref-12)
13. Or related institutions such as money market mutual funds. [↑](#footnote-ref-13)
14. Nell-Breuning was the author of *Quadragesimo Anno.* [↑](#footnote-ref-14)
15. The Catechism is listed in the references as Catholic Church (1994). [↑](#footnote-ref-15)
16. See also Gregg (2016). [↑](#footnote-ref-16)
17. Interestingly, the Vatican’s 2018 letter uses the phrase “irrational exuberance” which is widely believed to have been coined by Shiller. [↑](#footnote-ref-17)
18. “Undesirable” might include destabilising the firm for which one is working or, indeed, destabilising the whole financial system; consumers taking poorly-informed decisions; or a range of other outcomes. [↑](#footnote-ref-18)
19. This is a technical economic term. In one of its manifestations, it describes a situation in which a seller of a financial product has more information than the buyer and thus caveat emptor can be problematic. [↑](#footnote-ref-19)
20. Prudence is the virtue that disposes practical reason to discern our true good in every circumstance and to choose the right means of achieving it (*Catechism*, 1806). [↑](#footnote-ref-20)
21. Again, see Alves et al (2018). [↑](#footnote-ref-21)
22. See Meuller (2003) for a discussion of the discipline, though Buchanan’s Nobel Laureate lecture (Buchanan, 1986) is a useful and digestible source. [↑](#footnote-ref-22)
23. See, for example, Bruni and Sugden (2013) as well as Hirschfeld (2018). Hirschfeld takes a distinctly Catholic approach which, of course, Adam Smith did not. [↑](#footnote-ref-23)
24. See, in particular *Rerum Novarum, Centesimus Annus* 1-22 (which also summarises *Rerum Novarum* on this topic) and *Quadragesimo Anno. Deus Caritas Est* (28) has a short, but very direct reference to the dangers of an over-bearing state, though this is in the context of addressing problems of poverty. [↑](#footnote-ref-24)
25. For example, see *Centesimus Annus* (48)in relation to regulation of human rights in the labour market and the development of the principle of subsidiarity in *Quadragesimo Anno.* [↑](#footnote-ref-25)