Department of
Economics and Finance

Economics and Finance Working Paper Series

Working Paper No. 16-18

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Ethics and Banking: Comparing an Economics and a Christian Perspective

October 2016

http://www.brunel.ac.uk/economics

ETHICS AND BANKING: COMPARING AN ECONOMICS AND A CHRISTIAN PERSPECTIVE

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Abstract: In this article, we seek to challenge the common approach of economics to ethics in banking, which can be characterized as pursuit of self-interest, even if it is realistic. We contend that widespread teaching of this approach, and its popularization, has been an important factor in the genesis of the financial crisis, albeit not the only one. In this we concur with Benedict (2009), that "business ethics risks becoming subservient to existing economic and financial systems rather than correcting their dysfunctional aspects". The approach of biblical theology, we contend, offers much greater challenges to unethical behaviour and hence deserves to be assessed seriously. There remains a difficulty of how the approaches that theology commends can be promoted in banking. Approaches could include the power of example, as well as enshrining the approach in remuneration mechanisms.

Keywords: Global financial crisis, banker's ethics, economics, biblical theology
JEL Classification: D63, D64

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Introduction

The issue of bankers' ethics came strongly to the fore in the financial crisis of 2007-9 when a wide range of unethical practices were revealed. This has led to a wider exploration of the causes of such practices, evolution of regulation to counteract the related incentives (such as Basel III) and wider discussion as to whether regulation is sufficient to eliminate them.

We contend that regulation is necessary but not sufficient to "make ᴀ M

“Normative” economics typically asserts that given a distribution of assets in the economy, the pursuit of self-interest will lead to an optimal outcome for all. Taken to its extreme, such an approach leads to laissez-faire policies and tends to exclude considerations of justice. (To include considerations of justice economics requires some element of political theory such as that of Rawls (1971)).

Interestingly, this self-interested perspective was not wholly shared by the founder of economics, Adam Smith (2002), to whom it is commonly attributed (the invisible hand of the pursuit of self-interest leading to general benefit). He believed that “society cannot subsist among those who are at all times ready to hurt and injure one another”. He also argued that: “Man . . . ought to regard himself, not as something separated and detached, but as a citizen of the world, a member of the vast commonwealth of nature and to the interest of this great community, he ought at all times to be willing that his own little interest should be sacrificed” (Freidman and Adler 2011). Furthermore, there is good evidence that he believed the invisible hand to be directed by God himself , drawing for example from Augustine (“the invisible hand of God that heals and makes whole”) (Harrison 2010).

Economics and its view of humanity offer a good diagnostic analysis of policy issues and economic development. Yet it is weak normatively due to its focus on efficiency and not values; in its view of the economy as a technical matter, autonomous from the rest of social relations and the moral sphere. Whereas virtues such as trustworthiness and honesty are vital for the smooth running of the economy, irresponsibility and immoral behaviour can only be condemned ethically in the economics framework if they are “irrationally” contrary to the self-interest of the individual perpetrator, or possibly to the efficiency of the corporation.

Like economics, biblical theology looks both at how things are and how they ought to be. Humanity, although made in the image of God, is fallen. Therefore, choices and actions are indeed often determined by self-interest, relationships can be spoilt by power and fear, humanity may exploit nature, and work can become toil. A biblical view of humanity is more rounded than that of economics, with community life seen as crucial and not just individual fulfilment. While wealth is celebrated at times as indicating God’s blessing, it is the relationship with God that a Christian sees as central to well-being.

Being made in the image of God, humans have free choice but also responsibility. Choices may entail money becoming an idol, and the economic system pervaded by “structural injustices”, which disadvantages those with least resources. Indeed, the strong normative element of the Bible has justice at the core. Accordingly, Christianity offer a critique of economics, with underlying concerns focused on aspects such as stewardship, useful work, protection for the vulnerable, and preservation of family life. Equally, whereas the state is places suggests that there have been failures in inculcating the right values”. Furthermore, as argued in Benedict (2009) economics as usually taught ignores the issue that “every

A **second resolution is to rely on reputation**. If the agent sees their reputation for honesty as an asset, they will be trustworthy because it's in their own interests. People can after all be fired, and institutions can fail or be taken over. Spoil your reputation once, and no one will trust you again – at least for a few years. But this is more effective for a single individual or institution that behaves differently from the rest. In the credit boom, bankers were comforted by the were takeovers undertaken at excessive prices, which threatened the bidding firm's solvency? Equally, economics is silent on the ethical issues of prudence, trust, and honesty that are essential to the functioning of financial markets in the long term. We now turn to a Christian view to see what additional insights are available.

3

hence their bonuses. Equally, leadership in firms that should be benign and for the benefit of all can become dictatorial as at Lehmans, in the same way that marital relationships can sour.

(2001) argues that work generally, and market enterprise more specifically, can be seen to have a legitimacy based on the "creation mandate" which is to order creation for mankind's needs.[5] Furthermore, drawing on Martin Luther's concept of the goodness of all human vocations, Weber (2002) produced the well-known sociological analysis of the significance of the 'Protestant work ethic'. Weber's analysis suggests that these biblical ideas have informed Western models of work and leisure, and our ethics of employment, to a significant extent. For example, the idea that **work provides human beings with meaning and significance** is clearly in line with biblical teaching, but is not part of standard economic analysis of work as disutility.

Work should be in effect the fulfilment of spiritual life (Kim et al 2009). This is evident, for example, in the **skilled work** of Bezalel on the tabernacle, which is celebrated in Exodus 31:2-5, and which was accompanied by his being "*filled with the Spirit of God*". This work was not just for the self; but to be passed on as evident from Exodus 35:34: "*he has given both him and Oholiab son of Ahisamach, of the tribe of Dan, the ability to teach others*". Psalm 128: 2 says "*You will eat the fruit of your labour; blessings and prosperity will be yours.*" The "wife of noble character the way wealth is used and the attitude of gratitude to God for it is what matters. We should see ourselves as caretakers for the wealth we have which derives from God as in Deuteronomy 8:17-18

you the ability to produce wealth, and so confirms his covenant, which he swore to your ancestors, as it is today." We are called to share it with the needy as in the Book of Ruth where the crops in the corner of the field are left for the destitute to harvest.

Wealth is good but greed is not. Hence the importance among the ten commandment to not covet which entails greed and lust (

(Exodus 20:17). Coveting others' bonuses is clearly common in modern financial institutions, leading to breakdown of relationship and temptation to unethical behaviour.

From a biblical point of view it is unsurprising that **even for people who are very highly paid and wealthy, happiness and satisfaction are often absent** as Ecclesiastes 5:11:

And it is clear that many bankers are dissatisfied, despite their vast bonuses, with their extremely stressful lives, long hours, and resultant risk of relationship breakdown.

Jesus knew that one could never have a satisfactory life being in love with money.[6] In the context of the bonus culture and high remuneration of bankers, Jesus' **warnings of the dangers of greed** are appropriate,[7] such as in the parable of Lazarus and the rich man (Luke 16:19-31). A rich man was completely oblivious of the beggar Lazarus outside his gates, and his death, and his destiny was perdition**.** In the same way that individuals who operate in impersonal markets can be blind to the individual community, and indeed global consequences of their actions (bankruptcy, repossession, lost savings and pensions). Again, Paul warns that *tation and a trap* (1 Timothy 6:9). Many bankers did exactly this when they proceeded to cut corners in the areas of prudence, diligence, and risk assessment.

3.4 The bible and banking

Turning more specifically to biblical material relevant to banking, **diversification of portfolios** is comparable to the recommendation to hedge risk of disaster by Solomon in Ecclesiastes: *Cast your bread upon the waters, for after many days you will find it again. Give portions to seven, yes to eight, for you do not know what disaster may come upon the land.* (Ecclesiastes 11:1-2) It was evident that sub-prime ABS's did not diversify sufficiently the underlying credit risk, in the way securitized products are supposed to. In the light of this, banks became vulnerable to liquidity and credit risk when the assets underlying the ABS defaulted, and liquidity in the ABS collapsed. And although on the liability side banks may have used a variety of wholesale funding sources and instruments, they did not allow sufficiently for a complete collapse of the wholesale funding market.

[6] On the breadth of Jesus' teaching on money, see Goodchild (2005), 2-6.

[7] "The seven deadly sins of banking include greedy loan growth, gluttony of real estate, lust for high yields, sloth-like risk management, pride of low capital, envy of exotic fees, and anger of regulators," Mike Mayo – CLSA, April 6th 2009 (thanks to Paul Mills for sending this quote).

On the other hand, Jesus appears to **commend advance risk assessment** in the case of the building of the tower and the preparation for war as for example Luke 14:28-30:
one of you wants to build a tower. Will he not first sit down and estimate the cost to see if he has enough money to complete it? For if he lays the foundation and is not able to finish it,
was not able to
though again the parable also represents an analogy for the Kingdom of God. His followers need to be ready to pay the price in terms of suffering of following him, as he concludes in Luke 14:33, again a form of advance planning:

One aspect of the Parable of the Talents of Matthew 25:14-30, suggested by Hoare (2006) is that Jesus **commends informed risk taking** (using the talent to make more money), while the risk-averse individual (who hid his talent in the ground) is condemned. But the risk taking that is commended is ultimately for salvation, and not for financial gain. And the point should not be exaggerated; the wider setting of the parable is not so much to do with risky actions per se as obedience and faith in the context of a relationship with a master. Jesus is using contemporary illustrations to stress the critical importance of repentance and acceptance of himself as Lord of the coming Kingdom.

3.6 The parable of the shrewd manager – the principal agent problem

Some of Jesus' parables contain principles that may be directly relevant to bankers' behaviour, such as the parable of the shrewd manager, which we consider sufficiently important to quote here in full:
manager was accused of wasting his p
is this I hear about you? Give an account of your management, because you cannot be

interests of the principal or client in varying situations. Similarly in today's world, trust is essential for financial markets. In fact, the root of the word "credit" or "credere" means trust.

In Jesus' parable, the manager wasn't trustworthy beforehand, for he'd been wasting the rich man's assets, with reckless irresponsibility. This parallels the actions of some in the financial sector up to 2007. And he wasn't trustworthy in the story of the parable itself as he gave away the master's assets. That's why Jesus calls him dishonest even as the rich man commends him for his worldly wisdom. And this is clearly relevant to banking ethics in terms of the principal-agent problem of economics as identified above. Jesus appears to be saying that our **trustworthiness is dependent on love and loyalty, and where they are directed**. Our treasure will be where our heart is. The manager was loyal only to himself – he showed no loyalty to the rich man and so their relationship was ruptured. In the latter part of the parable, Jesus is saying – don't be dishonest like him! We can only be loyal to one master. But the manager's behaviour seems very akin to the economic theory model, where love and loyalty simply have no role to play.

Scripture calls mankind to be trustworthy to God, and **we become trustworthy by being honest with money**. God judges humanity on small things and they can have a huge effect on destiny (Luke 16:10-11):
much, and whoever is dishonest with very little will also be dishonest with much. So if you have not been trustworthy in handling worldly wealth, who will tru

An **example of dishonesty** is the agents selling sub-prime loans to poor people in the US, knowing in their hearts they couldn't repay. They were well rewarded at the time, but their behaviour was not morally acceptable. This introduces a key verse (Luke 16:13):
can serve two masters. Either he will hate the one and love the other, or he will be devoted to

of example can pay dividends for the firm as well as leading individuals to Christ. In this context it is notable that many modern banks had their foundation in the Christian faith, for example Barclays was founded by Quakers.

Other mechanisms to encourage virtue might include appropriate selection of new employees, induction and training that emphasises virtue; emphasis on the importance of the firms' reputation; emphasising a sense of professionalism; allowing and protecting whistle blowers; design of the firm's architecture of management to ensure oversight of all staff; and reemphasis on virtue through regulation to the extent feasible.

But perhaps fundamental to reestablishment of ethical behaviour may be the resolution of the question of who is the ultimate master, you, the employer or God? Perhaps only when God is in charge of their lives will bankers see the incongruity of taxpayer support for their institutions and recurrence of large bonuses. Then they will see the injustice of it, given taxpayers are on average far poorer than the average banker.

We accept that virtues cannot be relied on alone – some people will always lack virtue and need regulations and values to be measured against. Values are enforceable while virtues are not – so they are needed as a backup. But we contend that a financial system that neither promotes nor rewards such virtue has the seeds of its own destruction.

From a secular viewpoint, another way to limit losses via "disaster myopia" is **to retain older bankers with corporate memory and experience of past crises** – otherwise the same mistakes tend to be made again. This has not tended to happen in practice as older bankers have tended to be made redundant, leaving in charge younger individuals with no memory of crisis. The Bible could be quoted in favour of this in terms of the good advice Rehoboam son of Solomon received from his elderly advisors (1 Kings 12), to reconcile himself with his restless subjects by easing their burden of tax and forced labour. In fact rather than taking the elders good advice, he took his inexperienced young friends' bad advice, to "act tough", and prompted the break-up of the kingdom.

4.2 The influence and size of the financial sector

A further policy to pursue is to reduce moral hazard from the "safety net" that generates incentives to act imprudently. It is clear that something has gone badly wrong for banks to in effect create the deepest recession since the 1930s. This raises the question whether banks, which were devised for the good of the community, have become self-seeking and destructive and too influential politically. **Attitudes to banks** may need to change. For example, in the words of the then UK Archbishop of Canterbury Rowan Williams (2008), it is easy to personify the market and capital "as if they were individuals, with purposes and strategies, making choices, deliberating reasonably about how to achieve aims. We lose sight of the fact that they are things that we make. They are sets of practices, habits, agreements which have arisen through a mixture of choice and chance." And so "we expect an abstraction called 'the market' to produce the common good or to regulate its potential excesses by a sort of natural innate prudence, like a physical organism or ecosystem. We appeal to 'business' to acquire public responsibility and moral vision."

Indeed, this is what the Bible calls **idolatry, attributing agency to something we have made ourselves** – and hence there is a need for discernment to avoid the risk of structural evil that such abstraction can lead us to. It can lead to foolish and destructive errors about the self-stabilizing nature of the economy or financial system, for example.[17] Such idolatry is also a way for individuals to seek to avoid responsibility by blaming the system or the institution when there were alternative choices that the individual could have made. Instead, biblical theology insists on individual responsibility for ones actions (as do secular systems of justice), for example Micah 6:8 "He has told you, O man, what is good; and what does the Lord require of you but to do justice, and to love kindness, and to walk humbly with your God?

Besides our attitude to it, the **size of the financial sector** could also be questioned. Following the point above, there may be greater political influence if the sector is large in the context of the economy – it is less likely to be challenged regarding ethics. Also foreign banks may be less susceptible to ethical challenge. Furthermore, there could remain questions on the value added by banking and finance. The head of the then UK regulatory authority the Financial Services Authority (FSA)[18], Lord Turner, raised the issue of a transactions tax on financial trading that would reduce the scope of speculation, and would likely reduce the overall size of the financial sector. Others have argued to break up the monopoly power of large banks, which also threatens financial stability. This, it can be argued, is in line with the implication of Revelation 18 (see Davis 2012) that the "Babylon" of the financial sector had become too powerful and influential for the economies it should serve.

Some legislation has of course been passed that moves in this direction. In the US, the Dodd-Frank Act imposed inter alia a prohibition on most proprietary trading by U.S. banks and their affiliates, subject to limited exceptions, and restricts covered institutions from owning, sponsoring or investing in hedge funds or private equity funds. The UK government has announced that there will be ring-fencing of retail banking operations from investment banking in conglomerates. This is intended to ensure that if UK banks get into difficulty with their investment banking operations, the bank for ordinary consumers will be protected and the investment-banking arm can be allowed to fail. The UK government has, however, stopped short of breaking up the banks, as was suggested at an earlier stage.

4.3 Relationships and market structure

The impersonality of the market, especially when structured products break the lender/borrower link, suggests a need to make finance again more a **question of personal relationships** – in line with scripture, where the doctrine of the Trinity teaches that God is relational, so human beings, made in his image, are inevitably relational also.. Moral hazard is reduced in close relationships, as in the household of biblical times where people could monitor one another closely – and also in "micro lending" in developing countries, where there is peer monitoring of use of the loan by groups of local people (who get a loan in rotation), and lending to women who are usually more responsible than men.[19 20]

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[17] Such beliefs, common among economists, are in fact contrary to the teachingSu EMC /oF t

Some wider issues arise in terms of **market structure and ethics**, largely from an economics standpoint. First, is ethical behaviour more likely under oligopoly or competition? In oligopoly there are wide margins and scope for non-competitive behaviour that could be ethical but also scope for exploitation. In competition, reputation is important and there is scope for customer switching, but also a need to maximise profits (and perhaps cut corners) to ensure survival. Contestable market might be a desirable balance for ethical behaviour, and mutuality as opposed to limited company structure. (Some of the worst failures in the UK were of former mutuals that became PLCs.) Ethics may depend on the time horizon, whereby unethical behaviour by banks may aid short run profit maximisation but affects reputation in the long run and hence customer loyalty It is importance that there is publicity to unethical behaviour and a role for "Consumers Associations" and better consumer understanding of financial products

Indeed, to ensure a "level playing field" between bankers and their customers there is also a need for **enhancing the understanding of financial products** by individuals. This may require regulation of complexity, i.e. not permitting products to be marketed that are judged too complex for retail consumers to understand. It also requires training of all individuals in finance, which could be undertaken by churches as well as in schools.

Conclusions

We have sought to challenge the common approach of economics to ethics in banking, which can be characterized as pursuit of self-interest, even if it is realistic. We contend that widespread teaching of this approach, and its popularization, has been an important factor in the genesis of the financial crisis, albeit not the only one.[21] In this we concur with Benedict (2009), that "business ethics risks becoming subservient to existingi!   x   rvk   x   {

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