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Inclusive capitalism: creating a sense of the systemic
Speech given by Mark Carney, Governor of the Bank of England
At the Conference on Inclusive Capitalism, London, 27 May 2014

Introduction
Inclusive capitalism is fundamentally about delivering a basic social contract comprised of relative equality of outcomes; equality of opportunity; and fairness across generations. Different societies will place different weights on these elements but few would omit any of them.

Societies aspire to this trinity of distributive justice, social equity and intergenerational equity for at least three reasons. First, there is growing evidence that relative equality is good for growth.1 At a minimum, few would disagree that a society that provides opportunity to all of its citizens is more likely to thrive than one which favours an elite, however defined. Second, research suggests that inequality is one of the most important determinants of relative happiness and that a sense of community – itself a form of inclusion – is a critical determinant of well-being.2 Third, they appeal to a fundamental sense of justice.3 Who behind a Rawlsian veil of ignorance – not knowing their future talents and circumstances – wouldn’t want to maximise the welfare of the least well off?

The problem: the growing exclusivity of capitalism
This gathering and similar ones in recent years have been prompted by a sense that this basic social contract is breaking down. That unease is backed up by hard data. At a global level, there has been convergence of opportunities and outcomes, but this is only because the gap between advanced and emerging economies has narrowed. Within societies, virtually without exception, inequality of outcomes both within and across generations has demonstrably increased.4 The big drivers of globalisation and technology are magnifying market distributions. 5 Moreover, returns in a globalised world are amplifying the rewards of the superstar and, though few of them would be inclined to admit it, the lucky.6 Now is the time to be famous or fortunate. There is also disturbing evidence that equality of opportunity has fallen, with the potential to reinforce cultural and economic divides. For example, social mobility has declined in the US undercutting the sense of fairness at the heart of American society.7 Intergenerational equity is similarly strained across the advanced world. Social welfare systems designed and enjoyed by previous generations may prove, absent reform, unaffordable for future ones.8 And environmental degradation remains unaddressed, a tragic embarrassment now seldom mentioned in either polite society or at the G20.

To maintain the balance of an inclusive social contract, it is necessary to recognise the importance of values and beliefs in economic life. Economic and political philosophers from Adam Smith (1759) to Hayek (1960) have long recognised that beliefs are part of inherited social capital, which provides the social framework for the free market.

Social capital refers to the links, shared values and beliefs in a society which encourage individuals not only to take responsibility for themselves and their families but also to trust each other and work collaboratively to support each other.9 So what values and beliefs are the foundations of inclusive capitalism?10 Clearly to succeed in the global economy, dynamism is essential. To align incentives across generations, a long-term perspective is required. For markets to sustain their legitimacy, they need to be not only effective but also fair. Nowhere is that need more acute than in financial markets; finance has to be trusted. And to value others demands engaged citizens who recognise their obligations to each other. In short, there needs to be a sense of society.

Social capital has been eroded
These beliefs and values are not necessarily fixed; they need to be nurtured. My core point is that, just as any revolution eats its children, unchecked market fundamentalism can devour the social capital essential for the long-term dynamism of capitalism itself. To counteract this tendency, individuals and their firms must have a sense of their responsibilities for the broader system. All ideologies are prone to extremes. Capitalism loses its sense of moderation when the belief in the power of the market enters the realm of faith. In the decades prior to the crisis, such radicalism came to dominate economic ideas and became a pattern of social behaviour.\textsuperscript{11} As Michael Sandel argued, we moved from a market economy to a market society.\textsuperscript{12} Market fundamentalism – in the form of light-touch regulation, the belief that bubbles cannot be identified and that markets always clear – contributed directly to the financial crisis and the associated erosion of social capital.

Ensuing events have further strained trust in the financial system. Many supposedly rugged markets were revealed to be cosseted:
- major banks were too-big-to-fail: operating in a privileged heads-I-win-tails-you-lose bubble;
- there was widespread rigging of benchmarks for personal gain; and
- equity markets demonstrated a perverse sense of fairness, blatantly favouring the technologically empowered over the retail investor.\textsuperscript{13}

Such practices widen the gap between insider and outsider returns and challenge distributive justice. More fundamentally, the resulting mistrust in market mechanisms reduces both happiness and social capital. We simply cannot take the capitalist system, which produces such plenty and so many solutions, for granted.

Prosperity requires not just investment in economic capital, but investment in social capital. It is necessary to rebuild social capital to make markets work. This is not an abstract issue or a naive aspiration. I will argue that we have already made a start with financial reform and that by completing the job, by returning to true markets, we can make capitalism more inclusive.

**What then must be done?**

There are a wide range of policies to promote inclusive capitalism from early childhood education, training and the importance of differentiated pathways and mixed-income neighbourhoods. These are all fundamentally political issues.

As an economist who should know the importance of comparative advantage, I will spend the balance of my time focusing on what central banks can do to support inclusive capitalism. The Bank of England’s mission “to promote the good of the people of the UK by maintaining monetary and financial stability” suggests that central banks have an important role to play in supporting social welfare.

Central banks can contribute in two areas. First, our core macroeconomic objectives promote social welfare. Second, we can help to create an environment in which financial market participants are encouraged to think of their roles as part of a broader system. By building a sense of responsibility for the system, individuals will act in ways that reinforce the bonds of social capital and inclusive capitalism.

Some of this is straightforward. Inflation hurts the poor the most and the real costs of financial instability – unemployment and the seizure of credit – are likely to be felt most acutely by the poor.\textsuperscript{14} Conversely monetary and financial stability are cornerstones of strong, sustainable and balanced growth and therefore directly affect distributive justice.

Some is more nuanced. While to not have acted would have been catastrophic for all, the distributional consequences of the response to the financial crisis have been significant. Extraordinary monetary stimulus – both conventional, through low short-term interest rates, and unconventional, through large scale purchases of assets – raised a range of asset prices, benefiting their owners, and lowered yields, benefiting borrowers at the expense of savers.\textsuperscript{15}

Central banks are not blind to these issues. Rather we recognise that decisions to redistribute wealth are rightly political, as are most policies that promote social mobility. It is only in extreme circumstances, such as in the wake of a financial crisis, that we can have some limited influence on
social mobility and intergenerational equity. That is because the depth and duration of recessions can profoundly affect the opportunities over the rest of the lives of affected workers. For example, a rise in unemployment by 5 percentage points is estimated to imply an average initial loss of earnings for new college graduates of around 9 per cent, an effect which is estimated to fade only after a decade.16 The persistent effects from adverse labour market conditions are much larger for individuals in the first year of their careers than for those with a few years of experience. And losses are magnified for those whose earnings are predicted to be lower, based on their college major.

The current situation in many advanced economies is very challenging: over 40% of recent graduates in US are underemployed17 and youth unemployment is around 50% in the worst affected countries in the Euro area. With clear risks of a misplaced if not lost generation, to the extent appropriate under our mandates, the monetary policy response has represented a race against long-term (or hysteretic) unemployment. As Janet Yellen remarked, “the risk that continued high unemployment could eventually lead to more-persistent structural problems underscores the case for maintaining a highly accommodative stance of monetary policy.”18

In Britain at least, these risks have been sharply reduced. The Bank of England has used a range of policies first to stimulate and then to secure the recovery. These have helped support the strongest job growth on record including record-high transitions back into employment by the longer-term unemployed. Longer-term social mobility will benefit from this track record.

Looking ahead, improvements in policy frameworks should help to reduce – but not eliminate – the incidence of financial crises. A core lesson of the recent episode is the need to think of the system as a whole. That is now reflected in the Bank of England’s responsibility to bring a macroprudential perspective to financial stability policy.

Financial reform and rebuilding social capital
Central banks’ greatest contribution to inclusive capitalism may be driving financial reforms that are helping to re-build the necessary social capital.

In doing so, we need to recognise the tension between pure free market capitalism, which reinforces the primacy of the individual at the expense of the system, and social capital which requires from individuals a broader sense of responsibility for the system. A sense of self must be accompanied by a sense of the systemic.

Consider four financial reforms that are helping to create this sense of the systemic and thereby rebuild trust in the system.

First, ending Too-Big-To-Fail
Perhaps the most severe blow to public trust was the revelation that there were scores of too-big-to-fail institutions operating at the heart of finance. Bankers made enormous sums in the run-up to the crisis and were often well compensated after it hit. In turn, taxpayers picked up the tab for their failures. That unjust sharing of risk and reward contributed directly to inequality but – more importantly – has had a corrosive effect on the broader social fabric of which finance is part and on which it relies. By replacing such implicit privilege with the full discipline of the market, social capital can be rebuilt and economic dynamism increased.

The leaders of the G20 have endorsed measures to restore capitalism to the capitalists by ending too-big-to-fail and, in response, the Financial Stability Board (FSB) has identified systemically important institutions; made them subject to higher standards of resilience; and developed a range of tools to ensure that, if they do fail, they can be resolved without severe disruption to the financial system and without exposing the taxpayer to loss. This is the year to complete that job. Governments must introduce legislative reforms to make all systemically important companies, including banks, resolvable. Jurisdictions must also empower supervisors to reach agreements for credible cross-border resolution plans. The FSB is developing proposals, for the G20 summit in Brisbane, on total loss absorbing capacity for institutions, so that private creditors stand in front of taxpayers when banks fail. In addition, we are working with industry to change derivative contracts
so that all counterparties stay in while resolution of a failing firm is underway.

Second, creating fair and effective markets
In recent years, a host of scandals in fixed income, currency and commodity markets have been exposed. Merely prosecuting the guilty to the full extent of the law will not be sufficient to address the issues raised. Authorities and market participants must also act to re-create fair and effective markets. In the Bank of England’s view, changes to both the hard and soft infrastructure of markets will be required. Examples of the former include reforming the calculations of benchmarks such as Libor or the daily foreign exchange fixes. The upcoming FSB report on these issues, co-chaired by the Financial Conduct Authority’s (FCA) Martin Wheatley and the Fed’s Jeremy Stein, will be decisive in this regard. Consideration should also be given to increasing pre- and post-trade transparency in a host of fixed income markets and accelerating the G20 pledge to move the trading of all standardised derivatives onto electronic exchanges and platforms.

Such changes are vital, but they cannot anticipate every contingency or discipline every miscreant. The scandals highlight a malaise in corners of finance that must be remedied. Many banks have rightly developed codes of ethics or business principles, but have all their traders absorbed their meaning? A first step to restore trust in markets might be to rely on traders’ intuitive understanding of what makes a true market. Consideration should be given to developing principles of fair markets, codes of conduct for specific markets, and even regulatory obligations within this framework. There should be clear consequences including professional ostracism for failing to meet these standards. The basic point is that all market participants, large and small, should recognise that market integrity is essential to fair financial capitalism. Confidence in the integrity of those markets needs to be reinforced alongside genuine competition to ensure that the needs of end customers are properly and effectively served. Doing so will reinforce the City’s well-deserved reputation as the world’s leading financial centre, with the most effective and efficient markets.

Third, reforming compensation
Dominic Barton and Mark Wiseman (2014) have detailed the need for long-term thinking by concentrating on shareholder incentives. A related lesson of the crisis was that compensation schemes that delivered large bonuses for short-term returns encouraged individuals to take on too much long-term and tail risk. In short, the present was overvalued and the future heavily discounted. To align better incentives with the long-term interests of the firm – and, more broadly, society – major changes are underway. At the request of G20 Leaders, the FSB has developed the principles for sound compensation practices to align incentives with long-term risks. Here in the UK, the Bank of England has adopted a new code for banks prescribing deferred variable performance payments, introducing the ability to reduce deferred bonuses when subsequent performance reveals them not to have been fully deserved, and paying bonuses in stock rather than cash. The deferral of bonuses awarded today allows them to be reduced before they are paid if evidence emerges of employee misconduct, error, failure of risk management or unexpectedly poor financial performance by the individual, their team or company.

We are continuing to refine our approach. The Bank has just completed a consultation on a requirement for variable remuneration to be clawed back after payment and will consult later in the year on new standards for bonus deferrals.

These provisions will apply not only to employees who are judged culpable directly, but also to others who could reasonably have been expected to identify and manage risks or misconduct but did not take steps to do so, and senior executives who could reasonably be deemed responsible by establishing the culture and strategy of the organisation.

Where problems of performance or risk management are pervasive, bonuses should be adjusted for whole groups of employees.

Of course, no compensation package can fully internalise the impact of individual actions on systemic risks, including on trust in the system. To do so, market participants need to become true
stakeholders. That is, they must recognise that their actions do not merely affect their personal rewards, but also the legitimacy of the system in which they operate.

**Fourth, building a sense of vocation and responsibility**

To build this sense of the systemic, business ultimately needs to be seen as a vocation, an activity with high ethical standards, which in turn conveys certain responsibilities.

It can begin by asking the right questions. Who does finance serve? Itself? The real economy? Society? And to whom is the financier responsible? Herself? His business? Their system?

The answers start from recognising that financial capitalism is not an end in itself, but a means to promote investment, innovation, growth and prosperity. Banking is fundamentally about intermediation – connecting borrowers and savers in the real economy.

In the run-up to the crisis, banking became about banks not businesses; transactions not relations; counterparties not clients. New instruments originally designed to meet the credit and hedging needs of businesses quickly morphed into ways to amplify bets on financial outcomes.

When bankers become detached from end-users, their only reward becomes money. Purely financial compensation ignores the non-pecuniary rewards to employment, such as the satisfaction from helping a client or colleague succeed.

This reductionist view of the human condition is a poor foundation for ethical financial institutions needed to support long-term prosperity. To help rebuild that foundation, financiers, like all of us, need to avoid compartmentalisation – the division of our lives into different realms, each with its own set of rules. Home is distinct from work; ethics from law; the individual from the system.20

This process begins with boards and senior management defining clearly the purpose of their organisations and promoting a culture of ethical business throughout them. Employees must be grounded in strong connections to their clients and their communities. To move to a world that once again values the future, bankers need to see themselves as custodians of their institutions, improving them before passing them along to their successors.

In the UK, two important initiatives are in train to help accomplish these ends.

The first is a new regime for regulating the senior-most managers of banks. That regime, proposed by the Parliamentary Commission on Banking Standards and now being established by the Bank of England seeks to reverse the blurring of the link between seniority and accountability that has developed over the years. Its underlying principles are relevant across the financial sector. People who run major firms should have clearly defined responsibilities and behave with integrity, honesty and skill regardless of whether they work for global investment banks, regional building societies or insurance companies. We are now considering a similar regime for senior persons in the insurance sector. This does not mean applying the banking regime indiscriminately. For one thing there is no statutory provision for applying a “reverse burden of proof” in insurance. For another, Solvency II requires us to monitor the fitness and propriety of a broader range of staff than in banks. In coming months we will build on the provisions of legislation to produce a regime that in spirit is aligned with the standards to which we hold bankers, but that in practice is a tailored approach for insurers. It will combine accountability with efficiency.

**Ultimately, of course, social capital is not contractual; integrity can neither be bought nor regulated.** Even with the best possible framework of codes, principles, compensation schemes and market discipline, financiers must constantly challenge themselves to the standards they uphold.

A meaningful change in the culture of banking will require a true commitment from the industry. That is why a second initiative, the creation of the Banking Standards Review Council (BSRC), is particularly welcome.21 This new independent body, again proposed by the Parliamentary Commission, is designed to create a sense of vocation in banking by promoting high standards of competence and behaviour across the UK industry. The BSRC will complement the work of regulators by setting out a single principles-based code of practice, based on the high-level principles now being considered by the Prudential Regulation Authority and FCA. Among other things, this should aim to guide behaviour in the face of conflicts of interest or of moral ambiguity. It will also identify activities where voluntary standards of good practice would be in the public interest, and work with industry
to develop them. And it will engage with banks to establish good practice in developing the competence and training requirements of staff covered by the Certified Persons regime. A prime objective of the BSRC will be to help individual banks and building societies to drive up standards of behaviour and competence through a process of internal and external assessment. It will work with banks to encourage a process of continuous improvement, and regularly assess and disclose the performance of each bank under the three broad headings of culture, competence and development of the workforce, and outcomes for customers. The BSRC is an important sign of banks’ recognition of the need for change. Its impact over time will be a crucial test of the industry’s commitment to that change.

Conclusion
By encouraging enterprise and rewarding individual initiative, market-based economies provide the essential conditions for economic progress. But social capital must be maintained for that progress to be consistently delivered. The combination of unbridled faith in financial markets prior to the crisis and the recent demonstrations of corruption in some of these markets has eroded social capital. When combined with the longer-term pressures of globalisation and technology on the basic social contract, an unstable dynamic of declining trust in the financial system and growing exclusivity of capitalism threatens. To counter this, rebuilding social capital is paramount. Financial reform is now helping. Globally systemic banks are simplifying and downsizing. Some are de-emphasising high-profile but risky businesses that benefited employees more than shareholders and society. Authorities are working feverishly to end too-big-to-fail. The structure of compensation is being reformed so that horizons are longer and rewards match risk. Regulation is hard-wiring the responsibilities of senior management. And new codes are seeking to re-establish finance as a true profession, with broader societal obligations. A welcome addition to these initiatives would be changes to the hard and soft infrastructure of financial markets to make them dynamic and fair. Through all of these measures, finance can help to deliver a more trustworthy, inclusive capitalism – one which embeds a sense of the systemic and in which individual virtue and collective prosperity can flourish.
The future of financial reform - speech by Mark Carney
17 November 2014

INTRODUCTION
It is now more than seven years since the first tremors of the earthquake that was to rock the financial system in 2008.

After the blood of the crisis, years of sweat and toil from authorities across the globe, and not a few tears from the financial sector, the job of agreeing measures to fix the fault lines on which the financial system had been built is now substantially completed.

The financial system today is vastly different from its pre-crisis self. That change didn’t ‘just happen’: it is the intended, positive result of the G20/FSB reform agenda. The Brisbane G20 Leaders’ summit just completed was a landmark. The prudential requirements and supervisory framework for banks are largely settled. There will be adjustments, if necessary, but from a prudential perspective, banks now know what they need to do. It is now a question of implementation. The result of the agreed reforms will be that:

The system is safer. Banks were woefully undercapitalised – many of the largest banks were levered 40 to 50 times. They are now much more resilient. As banking systems around the globe implement fully the new framework, a system that was built precariously on sand will stand more firmly on rock.

The system is simpler. Before the crisis, risks were hidden and financing chains were fiendishly complex. Banks were complacent, building business models on the belief that “this time is different” and assuming markets would be continuous and deep. They were enthralled by models to the extent that every bank that failed or was rescued by the state reported on the eve of their collapse that it substantially exceeded the Basel risk-weighted capital requirements. Now, disclosure standards have been significantly improved, contingent exposures are on the balance sheet, essential wholesale markets are more reliable, and capital standards are more robust.

The system is fairer. Banks were in receipt of large public subsidies. In Brisbane we reached a watershed in ending too big to fail, with agreements to take forward proposals on total loss absorbing capacity for globally systemic banks. Globally systemic banks that fail will in future be resolved without recourse to the taxpayer and without jeopardising financial stability.

Does that mean the job of financial reform is complete?
No. Implementation must follow agreement. Our perspective cannot be only to look back. Just avoiding the repeat of past failures is not a recipe for success. Agreeing to measures to fix the fault lines is necessary and important, but not sufficient. We must now consolidate our progress to build a financial system that can deliver strong, sustainable and balanced growth for all economies: large or small; advanced or emerging; home to large financial institutions or host to them.

Success would be a global financial system that maximises its full potential to ensure that:
- The payments infrastructure is efficient and reliable;
- Companies can access the working capital they need to operate;
- Liquid savings are transformed into long-term loans;
- Core markets function continuously to allow risks to be diversified and managed; and
- Capital is allocated efficiently across the globe.

Achieving these ends requires a financial system supported by three pillars: diversity, trust and openness. Building these pillars should be the focus of the future reform agenda.

A diverse system, with market-based as well as bank-based finance, can best support a wide variety of investment from infrastructure to SMEs that is necessary to create the jobs our citizens deserve.

A trusted system can retain its social licence to support the real economy in innovative and efficient ways.

An open system can avoid the risk of Balkanised finance, which would reduce the efficiency with which savings are matched to investment and lead to a global misallocation of scarce capital.
This is a daunting agenda and some might feel that, having apparently reached the finish line, the race has been extended. Indeed there will be inevitable calls by some vested interests to turn back. To give in, to drop out, would be a tragedy.

The prize for running the longer race is great. By fixing the fault lines that caused the last crisis we have created strong foundations for a truly global financial system that can benefit us all. Now we must have the courage to seize that opportunity and build on those foundations.

Today I will refresh the case for financial reform and set out what I believe should be the drivers of the future reform agenda. But before turning to that next stage, allow me to take stock of the immense amount that has been accomplished since the crisis.1

1 A detailed progress report is contained in the FSB Chair’s letter to G20 Leaders ahead of the Brisbane Summit. See FSB (2014b).

COMPLETING THE JOB OF FIXING THE FAULT LINES

A safer financial system

Banks are now much more resilient. They have more capital, more liquidity and are less susceptible to procyclical spirals. Capital requirements for banks are much higher, as are risk weights and the quality of bank capital. In all, new capital requirements are at least seven times the pre-crisis standards for most banks. For globally systemic banks, they are more than ten times.2 Large internationally active banks are on course to meet the new requirements 4 years ahead of the 2019 deadline. Despite the scale of the changes, the aggregate shortfall of those banks that still have shortfalls was €15bn at end 2013, having been €115bn two years ago.

It is just as clear that banks’ liquidity positions before the crisis were precarious. Now, for the first time, global standards have been agreed to place requirements on the liquid asset buffers banks must hold and on the extent of maturity transformation in which they can engage.

The rapid contagion during the crisis showed how the system magnified shocks. Two particular fault lines made the system procyclical.

First, banks were heavily exposed to movements in market prices and volatility around them, creating a cycle in which falls in prices caused banks to retrench and reduce their positions, leading to further falls in asset prices. That issue has been addressed through strengthening regulatory requirements on trading books – a move that has contributed to the share of banks’ assets accounted for by trading assets almost halving.3

Second, banks and shadow banks were entwined in a dangerous funding spiral. Incredibly low initial margins on repo transactions facilitated the build-up of excessive leverage and maturity mismatches in shadow banks. The first wave of losses led banks to tighten margin requirements, effectively reducing financing available to the non-bank financial system, causing those institutions to deleverage through asset sales, driving a death spiral of falling asset prices and rising margin requirements.

2 Table 1 shows that the tightening in definitions of risk-weighted assets and capital under Basel III itself doubled effective capital requirements. The numerical requirements themselves have also more than tripled. Caruana (2012) describes these changes in some detail.

3 Table 2 shows that the risk weighting of trading book assets has more than doubled. Despite accounting for only 5% of overall risk weighted assets, trading assets contributed more than one third of the overall increase in RWAs resulting from new regulatory requirements.

Banks have responded by shrinking trading books. Chart 2 shows that across all advanced economy SIFIs, the share of such assets on bank balance sheets has almost halved.

Such dynamics have now been mitigated through agreed minimum haircuts for securities financing transactions and the net stable funding ratio for banks.

A simpler financial system
As the crisis highlighted, opacity hides frailty. Why was subprime not contained? How did $200bn in credit losses ultimately cause well over $1trn in market losses? Because complexity obscured the link between ultimate creditor and debtor, it allowed false assumptions to develop that, when disabused, prompted panic. The mortgage originated by a bank was repackaged by a SIV, that financed it through ABCP, that was bought by a MMF, into which a retail investor placed their savings. It occurred to no one in the chain that the absence of a monitor would influence credit performance. The whole model was based on continual rollover. When subprime losses exposed the misalignment of incentives between loan originators and investors in asset-based securities, the whole system collapsed, imploding core funding markets for banks. Risks that had ostensibly been moved outside the banking system or diversified away were in fact just hiding and, when crisis struck, they came crashing back onto the balance sheets at the core of the system.

This complexity is being addressed. To protect against risks that banks think are low but are in fact not, a global definition of a simple leverage ratio has been agreed. In the UK, the Bank of England has just recommended powers to set a simple leverage ratio for domestically-regulated banks, building societies and investment firms. This will enhance the resilience of banks against risks that are hard to model. And it will ensure off-balance sheet exposures are properly capitalised. Retention and capital requirements for securitisations now have more closely aligned incentives between originators and investors. New requirements for money market funds have closed the gap between retail investors’ perceptions and their exposures. International standards are agreed to capture properly and limit off-balance sheet exposures. And the Basel Committee is developing the capital framework to ensure implicit offers of contingent support by banks, for example to their SIVs, will be properly capitalised. Interconnections created by derivatives are being reduced and made transparent. Requirements are being imposed, and incentives created, for banks to centrally clear derivative trades, helping to replace the complex web of bilateral deals with a central model. Trade reporting and margining requirements are being strengthened. More broadly, overall disclosure has been enhanced on the key risks arising from business models, sources of funding, market risk measures and loan forbearance policies.

Through such initiatives, complexity and obscurity are being replaced by simplicity and transparency.

**A fairer financial system**

That goes some way towards increasing the effectiveness of market discipline. But that discipline will never be felt fully if markets believe that creditors and shareholders will be bailed out in a crisis because banks are too big to fail.

Expectation of bail out was validated comprehensively last time. The US authorities sought to make Lehman Brothers a test case of moral hazard. Instead, this exception proved the rule. AIG was rescued within twenty four hours. As Barney Frank observed, the free market lasted for a day.

This ‘heads-I-win-tails-you-lose’ environment for the world’s largest banks struck right at the heart of the sense of fairness in our societies. It simply had to be fixed. Tackling the rampant moral hazard at the core of the system has not been easy but, at the Brisbane Summit, G20 Leaders marked a watershed in our efforts. Many jurisdictions have in place statutory regimes to allow the resolution of failing banks. But until now, the potential use of those regimes on systemic and cross-border institutions has been in doubt.
G20 Leaders endorsed two proposals that will allow global systemically-important banks to be resolved when they fail, without the need for taxpayer support and without disruption to the wider financial system or real economy.

The first is an agreement, catalysed by the FSB, between ISDA and an initial group of 18 global derivatives dealers. Much of this has been driven by the FSB and the joint public-private Enhanced Disclosure Task Force. Across the major jurisdictions, the recommendations of the taskforce are more than half way towards full implementation. Banks in the UK have implemented 95% of the recommendations. The latest progress report is in Banziger et al (2014).

This new Protocol prevents derivative contracts being terminated disruptively in the event of a bank entering resolution. It is a crucial step to closing off the risk that foreign counterparties take their money and run. Most jurisdictions already have legislation that achieves this nationally, but for global banks national solutions aren’t sufficient. This new agreement fills the gap by extending the approach across borders. Together with existing legislation that applies stays domestically, the ISDA agreement means that over 90% of the dealer banks’ OTC bilateral trading activity will be covered by either contractual or statutory stays.

The second initiative is yet more significant. It is a proposal for a common international standard on the total loss absorbing capacity that globally systemic banks must have. It will ensure that shareholders and creditors who benefit in the normal course of business also absorb losses when banks fail.

It will establish a level playing field between global systemic banks, while taking into account differences in national resolution regimes.

It will set clear roles for home and host regulators in a resolution. And it will give host nations the confidence that they won’t again be side-swiped by the failure of a large foreign bank.

It will ensure globally systemic banks finally have the quantum of total loss absorbing capacity that minimises the costs of an unsafe banking system. And, by removing the implicit subsidy that systemic banks have long enjoyed, it will re-establish market discipline.

This proposal will of course be subject to public consultation and comprehensive impact assessments. Markets and rating agencies are already adjusting to the determination of authorities to end too big to fail. Credit ratings for globally systemic banks have been downgraded to reflect the much lower probability of state support. Market prices suggest the implied subsidy has been substantially reduced as the expectation of public bailouts dies away. However, we have more to do in order to make cross-border resolution the only expected outcome in the event an institution fails.

6 Clear principles and a detailed indicative term sheet covering the necessary amount, type and location of loss absorbing capacity are now being consulted on. See FSB (2014a).

The TLAC standards must be finalised next year and then implemented fully. Resolution plans for individual firms must be finalised and legal and operational impediments removed. Arrangements for the funding of firms in resolution must be put in place. Legislation must be enacted to allow regulators to give effect to the resolution actions of authorities in other jurisdictions.

And the solution of the too big to fail problem in banks must be broadened to include all systemic institutions, including insurers and critical financial market infrastructures, through designation, more intensive supervision and standards for loss absorbing capacity.

We recognise that our success can never be absolute. Specifically, we can’t expect to insulate fully all institutions from all external shocks, however large. But we can change the system so that systemically important institutions, their shareholders and their creditors bear the cost of their own actions and the risks they take.

THE FUTURE OF REFORM

With a safer, simpler and fairer system in place, the FSB can begin to look ahead to how, collectively, we will engage in the next phase of reform and regulate and supervise the global system.
The foundations are laid. The next stage of reform should build a system that serves households and businesses to its full potential. Such a system must be supported by pillars of diversity, trust and openness.

Diverse
Although banking remains the most important business by some margin, the increase in the relative price of bank-based intermediation has encouraged a shift towards market-based intermediation. Virtually all net credit growth since the crisis has been in bond rather than bank finance.8 Non-bank financial sector assets have grown by 130% over the past decade and are now equivalent to 120% of global GDP.9 Managed properly, that represents a welcome increase in diversity within the global financial system. If banking again comes under stress, these markets could act as a safety valve.

7 Chart 3 shows the implicit subsidy to the top 4 UK banks. At the height of the crisis it reached almost £140bn per year but has now shrunk dramatically.
8 Chart 4 shows that non-securitised loans continue to account for almost 30% of global financial assets. Corporate bonds and securitised loans account for only 7%. Chart 5 shows that in each of the US, UK and Europe, the period since the crisis has seen the stock of outstanding bonds move towards the stock of outstanding bank loans.
9 See FSB (2014e).

For there to be diversity under adversity, the connection between banks and markets must be appropriately sized and durable. I noted how pre-crisis links meant that the collapse of subprime spilled over into the core of the system. The post-crisis connection must be wired differently, but not severed completely.

Banks are needed to overcome the information asymmetries that prevent direct market access for smaller borrowers. But with the right standards an appropriate boundary between banking and securitisation can be drawn and financing capacity increased. With securitisation markets effectively closed, even in Europe where loss rates on consumer-related securitisations were one twentieth of those in the US, smaller borrowers are not being served by market-based finance.10

In response, the Bank of England and ECB are working to promote a sustainable model of securitisation that is Simple, Transparent and Comparable.11 In other words, one that allows banks to originate and distribute assets for which credit assessment can be most readily performed in the market. Simple, transparent and comparable securitisations will support improved calibration of risk weights and retention requirements for banks and prudential standards for insurers that Ravi Menon has advocated.12

Greater reliance on market-based finance will need to be matched with measures to ensure its resilience. The international community will need to shift focus to new risks and vulnerabilities, many of which will emerge outside the banking system. As Deputy Prime Minister Tharman Shanmugaratnam has noted, the safety of finance will depend “on whether we stay intensely alert to the risks of the future, including especially the risks we do not yet see or know, rather than focus only on preventing the last crisis from recurring.”13

The FSB has set up a broad-based network for information-sharing and reporting on the scale of shadow banking activity. This work is far from academic because, although you wouldn’t necessarily know from a reading of financial market indicators, these are riskier times. There is a disconnect between developments in real economies and the degree of financial risk taking.

It is particularly notable how the search for yield has compressed liquidity premia across markets. This is unlikely to be sustainable over the medium term because it exists against a backdrop of much-reduced market-making activity.14 Fundamentally, liquidity has become more scarce in secondary fixed income markets. It just appears that it hasn’t.
The reasons for the changes are clear however. New prudential requirements have reduced incentives for banks to warehouse risk positions. Dealer inventories in fixed income have declined by 70% since the pre-

10 Chart 6 shows the post-crisis collapse in European securitisation issuance, which has been particularly concentrated in residential mortgage-backed securities.

11 Bank of England and ECB (2014) is a consultation paper on the development of such a model of securitisation. The EBA is also consulting on the same issue, see EBA (2014).

12 Menon 2013.
13 Shanmugaratnam (2013).

14 Chart 7 shows model-based estimates of liquidity premia across corporate bond markets. On these measures, premia have returned to their pre-crisis levels.


16 Chart 10 shows the increasing share of ‘redeemable funds’ in overall assets under management.

17 Chart 11 shows the particularly sharp growth in assets under management in high-yield funds.

18 Although they were short-lived, the bouts of market turmoil in the past year have illustrated how there can be sudden and sharp outflows, particularly from high-yield and emerging market funds, resulting in illiquidity in the markets for those instruments.

In part the current liquidity illusion is a product of the risk asymmetries implied by the zero lower bound on interest rates, excess reserves in the system, and perceived central bank reaction functions. However, interest rates in advanced economies won’t remain this low forever. Once the process of normalisation begins or perhaps if market perceptions shift and it is expected to begin, a re-pricing can be expected. The orderliness of that transition is an open question.

Certainly, conventional leverage and liquidity cycles – while dampened by reforms – can be expected to operate. High volatility, combined with lower prices, will tighten financing conditions, forcing some asset sales, dampening prices and increasing volatility further. An overshoot is possible. Some have argued there is an additional risk arising from pricing and asset allocations based on an illusion of liquidity. This could lead to ‘redemption risk’ as detailed by Hyun Shin and others. Their argument begins with the observation that much of the shift towards market-based finance has been accompanied by an increase in assets under management.

We know that almost half of the $70 trillion in managed assets globally are in funds that offer their investors redemption at short notice. At the same time, funds are investing increasingly in higher-yielding, less liquid assets. One example of this has been the exponential growth in ‘liquid alternatives’, giving retail mutual fund investors access to hedge fund-like strategies.

The compression of liquidity risk premia suggests that investors are assuming any future withdrawals from funds will be conducted in an environment of continuous market liquidity and that the value of their fund holdings will not fall substantially when they exit.

The risks to that assumption are in only one direction. The dynamic that fund under-performance tends to be punished with outflows creates the possibility of the sorts of spirals that were previously associated with leveraged investors. That potential procyclicality is reinforced by the selling of volatility-linked products by funds seeking to boost income through insuring tail risks.

The macroprudential risk is that any revelation that continuous liquidity is illusory could generate potentially sharp changes in asset allocation. With net credit creation being largely reliant on bond finance, such a reallocation could generate a sharp deterioration in credit conditions for corporates and the risk may be particularly pronounced for cross-border flows to emerging markets.

But what, beyond talking about it, can be done about this risk?
Managing the risks in markets will require global co-ordination. The FSB provides the platform for authorities to monitor, analyse and address risks in a timely way. It brings all the relevant bodies together to develop this substantial body of work. Anticipating and managing market risk channels will be core to the future financial reform agenda.

This point is relevant to work, currently underway, to develop a framework for identifying globally systemic non-bank non-insurer financial institutions.

The fund management industry has become more concentrated, with the top 10 firms now accounting for almost one fifth of assets under management. However, size will not necessarily be the best indicator of systemic importance. It seems plausible that large unlevered funds with little maturity mismatch could pose few systemic risks. At the same time, smaller funds could be systemic if clusters of them conduct similar activities that do pose risks. Those activities include concentrated investments in illiquid assets, the potential for large short-term redemptions, and leverage, whether financial or embedded.

As such, there may be merit in this activity-based systemic risk assessment over and above a purely firm-focussed approach to systemic designation. Of course, identifying systemic firms is just the first step in managing risks to global stability. To manage those risks, authorities can do more to work with market intermediaries to enhance transparency and understanding around secondary market liquidity.

Securities market regulators may have an important role to play in developing globally-consistent best practices in liquidity risk management and valuations. Liquidity buffers and redemption schemes should be assessed. And greater standardisation of debt securities will also need to be supported. 18 Chart 12 shows the sudden and sharp reversals of flows into US high-yield bond funds and sets those flows in the context of funds’ liquidity buffers.

The need to ensure resilience in the non-bank financial sector also raises questions about the nature of central bank operations. The maintenance of an effective monetary transmission mechanism now requires backstops for both banks and markets. Bagehot will need to be updated for the 21st century, with central banks standing ready to operate frequently, against a wide range of collateral and a broader range of counterparties.

In short, diversity will reap rewards, but resilient diversity will require a significant programme of reform and alertness to new risks.

**Trusted**

The second pillar of the future of reform is to rebuild trust in finance.

Trust between institutions, counterparties and investors is central to maintaining the ability of finance to function.

Trust between regulators across jurisdictions is needed to maintain an open global system. And most fundamentally, trust between the public and the financial system is needed to maintain the social licence for finance to operate. It has been severely tested by: taxpayer bail-outs of systemic institutions; rewards perceived as undeserved; a perception that clients have become counterparties; and egregious examples of misconduct and rigging of markets.

Without that licence, the door will be opened to a level of regulation that constrains the ability of finance to innovate and support growth and trade efficiently. The licence will require consistent exemplary behaviour, and finance to have a clear sense of its purpose not as an end in itself, but as a means to promote investment, innovation, growth and prosperity.

It is not merely that we should want to follow Churchill’s wish to see “finance less proud and industry more content”. We want to see industry content and finance taking justifiable pride in its contribution to society. That is far from straightforward when, even six years on from the crisis and public bailouts, triggers for public opprobrium are plentiful. Last week, the UK’s Financial Conduct Authority, US CFTC and
Swiss FINMA fined six banks $3.3bn for misconduct in FX markets: misconduct that went on long after banks had already been fined for abusing interbank interest rate benchmarks. The repeated nature of these fines demonstrates that financial penalties alone are not sufficient to address the issues raised. Fundamental change is needed to institutional culture, to compensation arrangements and to markets.19

As Bill Dudley and my colleague Minouche Shafik have argued, the succession of scandals mean it is simply untenable now to argue that the problem is one of a few bad apples. The issue is with the barrels in which they are stored.20 Leaders and senior managers must be personally responsible for setting the cultural norms of their institutions. But in some parts of the financial sector the link between seniority and accountability had become blurred and, in some cases, severed.

The public were rightly angered that so many of the leaders and senior managers who were responsible for sowing the seeds of the crisis and for allowing cultures to develop in which gross misconduct took place have walked away from their actions or inactions.

In the UK, Parliament has established a stronger regulatory framework to allocate responsibilities to individual executives and board members and to give regulators the tools to hold them to account. The excuse of having delegated a responsibility simply will not wash. The public bail outs and the fact that few of the consequences of scandal have been borne by those who were directly responsible revealed a great deal about the balance of risk and rewards for those who worked in financial services. Compensation schemes overvalued the present and heavily discounted the future, encouraging imprudent risk taking and short-termism.

To align better incentives with the long-term interests of the firm – and, more broadly, society – major changes have been made. At the request of G20 Leaders, the FSB has developed principles and standards for sound compensation practices.

In the UK, we have introduced a remuneration code prescribing that payment of bonuses must be deferred for a minimum of three years and, after payment, be exposed to clawback for up to seven years. Bonuses can be reduced – or clawed back – if evidence emerges of employee misconduct or failures of risk management. We are consulting on extending deferral periods, widening the scope for groups of employees to have their bonuses reduced where there are more pervasive issues of performance or risk management, and considering options to prevent individuals side-stepping these rules.

In an international labour market there is a particular role for international standards and co-ordination to ensure a level playing field. It is unfortunate, for example, that new European rules to cap bonuses to half (or with shareholder approval, two-thirds) of total pay have the undesirable side effect of limiting the scope for remuneration to be cut back. This makes the case for additional reforms to ensure that the burden of excessive risk-taking and misconduct by staff can still be borne by those staff.

Standards may need to be developed to put non-bonus or fixed pay at risk. That could potentially be achieved through payment in instruments other than cash. Bill Dudley’s recent proposal for certain staff to be paid partly in ‘performance bonds’ is worthy of investigation as a potentially elegant solution.21 Senior manager accountability and new compensation structures will help to rebuild trust in financial institutions. In a diverse financial system, trust must also be rebuilt in markets. That is why in the UK in June, Chancellor George Osborne and I launched the Fair and Effective Markets Review.22 Far from seeking to constrain markets, the Review is seeking to restore true and competitive markets.

19 Chart 13 shows the sharp increase since 2010 in the number of FICC-related misconduct fines. The number of fines levied on 12 November alone amount to almost three quarters of the number levied in 2013.


21 See Dudley (2014) and Shafik (2014).
with open access to all and competitive prices. Behaviours that aim to undercut market mechanisms, such as collusion, the misuse of confidential information, or the manipulation of market prices and benchmarks, must be stamped out. The Review has already recommended that further market benchmarks be brought within the scope of UK regulation, alongside a criminal charge for manipulation of such benchmarks. In that respect it complements the FSB work to reform and strengthen benchmarks internationally.23

The Review is now consulting widely before reporting next June. It is asking questions about deficiencies in two major areas: market structure and conduct. The Review is examining where structures exist that encourage excessive concentration, raise potential conflicts of interest or expose benchmarks to the potential for manipulation. And it is considering where voluntary codes of conduct seem inadequate, poorly understood or simply provide individuals with justification to judge their actions by the exact letter of the code rather than by more generally accepted norms.

21 See Dudley (2014).
23 See FSB (2014c).

The Review will explore ways to improve market transparency, competition and trading infrastructure. Principles of fair markets, codes of conduct for specific markets, and even regulatory obligations can all help.

There must be clear consequences - including professional ostracism - for failing to behave properly.

In global markets, these are not things that any country can achieve on its own. Global solutions are needed. That is where the FSB, working with IOSCO and others, can play a role in delivering fair and effective markets on the global stage by forging international agreement on common standards and structures and co-operation between authorities. International firms must play their part too. Only with such global action can we begin to move on decisively from the scandals of recent years to slowly rebuild slowly the trust of society in finance.

We must build trust in other ways too, including the trust of financial markets in the safety and soundness of the firms operating in those same markets. Banks’ internal models proved woefully inadequate in the crisis, and there remain worryingly large differences in banks’ RWA calculations that cannot be adequately explained. That is why the plan the Basel Committee announced earlier this month to address these differences and to balance the risk-sensitivity and complexity of capital calculations is so important. Of course, the leverage ratio will play an important as a simple backstop against overreliance on models and past statistical relationships.

Open
Trust is also needed in a wider context: trust between countries in their supervisory and regulatory frameworks so as to support an open and stable financial system.
To achieve its full potential, the financial system must remain global. Fragmentation will reduce the efficiency with which savings are allocated to investments, and potentially lead to misallocation of capital on a global scale. All economies would be harmed by this, whether advanced, emerging or developing. This is a real risk. Since the crisis, measures of capital market integration have declined notably.24 A clear home bias remains in investment. The crisis was a vivid reminder that openness must be built on the foundation of stability and trust in the foundations of the global financial system.

24 Chart 14, from Haldane (2014), shows the correlation between national savings and investment. That correlation had reached zerojust before the crisis, suggesting that the global financial system was fully integrated. However, this has now reversed sharply. Sapir and Wolff (2013) document the home bias in equity markets even within the euro area.

For an open system, trust between authorities is therefore fundamental.
Although markets and many financial institutions are global, regulation remains national or regional and concerns about spillovers from failures of foreign institutions, or market contagion starting elsewhere, can prompt jurisdictions to safeguard themselves unilaterally. A national regulator’s first responsibility is to do its utmost to ensure the safety and soundness of its own jurisdiction. To avoid the Balkanisation of finance, each regulator must trust others to implement agreed common standards. In this regard, Singapore is a world leader. The IMF concluded its latest Article IV Report noting that financial regulation and supervision here is “among the best globally and...a frontrunner in implementing global regulatory reforms”.25

Trust can be sustained only if all countries follow the example of Singapore to implement standards consistently, fully and in a timely way. To provide confidence that full and consistent implementation is taking place, the FSB will support that with rigorous and transparent peer reviews and implementation monitoring.

We are providing clear and simple reporting, through the work chaired by Ravi Menon in our Standing Committee on Standards Implementation. In my letter to G20 Leaders last week, I provided that Committee’s latest findings of our monitoring process, in a simple summary with report card. From next year, the FSB will further enhance this reporting, through an annual reporting process on implementation. This will seek to highlight both shortcomings and good practice, and will seek to assess whether reform measures are having unintended effects and must therefore be adjusted. The FSB’s work will include focus in particular on the effects in emerging markets. When a robust analysis is completed, the FSB will be prepared to draw lessons from these reviews to refine the regulatory framework.

Trust also requires confidence that others are alert to new risks. Initiatives to collect and share data are important – whether it be the hub built at the BIS for sharing data on the balance sheets of cross-border banks, the global aggregation of trade repository data in markets such as derivatives or repos, the global legal entity identifier, or enhanced operation of supervisory colleges and crisis management groups for systemic firms.

Those are complemented by initiatives to share analysis, assessment of risks and tools to address those risks, including in shadow banking and other forms of finance. The FSB provides a platform for this. Through shared analysis, authorities can build confidence in each other’s work and trust in the policy responses being applied. This must encompass not just major institutions but also emerging markets that act as hosts to global institutions and that depend on global markets.


Building trust is a precondition for openness. It can also be drawn on to regulate the global system as efficiently as possible. Even with agreed common minimum standards, there will always be differences in national approaches to regulation. Such differences can be appropriate, reflecting different stages of development and different economic structures.

Efficiency in regulating global institutions and markets will require the development of approaches to defer to each other in the cross-border application of market regulations. The alternative is the inefficient imposition of multiple regulatory regimes on the same markets and institutions. In this regard, the way is being led in OTC derivatives regulation where progress has been made in establishing that regulators should defer to each other, based on an assessment of whether their regulatory regimes deliver similar outcomes.

Urgency is needed in applying that principle if we are to alleviate reductions in market liquidity and FSB members should begin to consider whether and where more widespread adoption of flexible approaches to regulating could be exploited.

The FSB is fully committed to supporting continued openness of the global system and to pursuing a new phase of global financial reform. To ready itself for its new roles, it has agreed changes to the structure of its representation, strengthened the inclusiveness of its working procedures and taken steps to increase the transparency of its operations.26
Currently emerging economies are on track, by the middle of the century, to account for the majority of G20 GDP and equity market capitalisation. It is essential that their increasingly important role in the global economy is reflected in the FSB and other international organisations. The changes we have made to increase the number of seats held by emerging markets will allow us to reflect that while maintaining effectiveness in decision making.

THE BENEFITS OF REFORM
Having argued for the extension of the reform race, I am conscious of the risk of fatigue. But as Ravi Menon argued more than a year ago: “it is imperative that we press on with the reform agenda and do not succumb to reform fatigue.”

 Already we can hear some of the runners, particularly those at the back, making world-weary arguments that more reform will hurt jobs and growth, and even that financial crises are just something that happens every five to seven years. If that were true, we are due for another crisis about now. Does anyone find that acceptable? As the memory of the crisis fades, it will be ever more important to explain the benefits of reform to counter the fatalism. So let me take this opportunity to take stock of the benefits of reforms, both of those already agreed and of the next phase of reform I have outlined. While we all recognise that future crises can never be ruled out, the steps taken to make banks safer and simpler have certainly reduced the likely frequency and severity of future financial crises. In doing so, they have reduced the exorbitant costs of instability.

The Basel Committee assessed in 2010 that the economic cost of the median financial crisis amounted, over time, to 60% of national income. With a 5% probability of a crisis each year, that is equivalent to annual costs of 3% of GDP. For the G20 as a whole that is $2trn. By eroding these costs, financial reform alone can therefore more than deliver the G20 commitment to raise GDP by more than 2%. The Basel Committee found these costs to be minimised only if risk-weighted bank capital ratios were raised above 15%. The Basel III requirements did not go this far, in part because they anticipated the additional requirements for loss absorbing capacity that G20 Leaders have just endorsed. Once implemented, the combined effects of the reforms will take the system much closer to the degree of safety needed to minimise the costs of financial crises. That authorities have reached this point in a measured way – allowing both equity and forms of debt to qualify as loss absorbing capacity – shows our sensitivity to the potential costs of greater safety.

What are those costs? Three points are worth emphasising.

First, the Basel Committee study judged that each 1% increase in capital ratios could reduce output by just 0.1% as higher bank funding costs were passed through to borrowers. However, even that small number seems an upper bound. It fails to take account of the fact that monetary policy can offset the impact of higher lending spreads on effective borrowing rates.

Second, the transitional costs of moving to higher capital requirements were found to be a little higher than the long-run costs. But that result depends on the starting position. Outside of financial

26 FSB (2014d) reports on the changes to the structure of FSB representation.
27 Menon (2013).

28 See Basel Committee on Banking Supervision (2010a).
29 See Basel Committee on Banking Supervision (2010b). Furthermore, reforms to OTC derivative markets were found to have supplemented that by a further 0.1% of GDP. By making the system simpler, these reduce the probability of crises. See Macroeconomic Assessment Group on Derivatives (2013). In fact, the need to offset the impact of higher lending spreads is one reason why some advanced economy central banks, such as the Bank of England, are so clear now that interest rate increases, when they come, will be gradual and limited.
booms, undercapitalised banking systems do not provide the credit needed for economic growth, regardless of capital requirements.

Where banking systems have raised capital and restored trust in their creditworthiness, access to credit has returned. This central lesson from the US and the UK recoveries could not be clearer. The evidence internationally suggests much the same. With the possible exception of parts of the euro area, lending spreads have fallen and credit volumes have increased at the same time as capital has gone up. In other words, if anything, regulators may have significantly overestimated the transitional costs, or even possibly got the sign wrong.

**Third**, although tighter regulatory requirements have caused bank balance sheets to shrink, that does not translate fully into reduced access to credit for real economy borrowers. As I said, some of the reduction in bank-based intermediation has been substituted with market-based finance for the real economy. Moreover, as bank balance sheets have shrunk, and as they have rebalanced more towards traditional banking than trading, they have become more focussed on the real economy. In short, any serious look at the experience of post-crisis reform shows that reform and regulation support – not damage – long-term prosperity.

Furthermore, the reforms have also brought benefits in terms of the distribution of the costs and benefits of finance. The removal of the implicit taxpayer subsidy transfers the costs of excessive risk taking to private creditors and away from the taxpayer. And by making resolution of failing institutions a real possibility and facilitating smooth exit, the reforms will also promote competition. Before the crisis, the largest and most systemic firms enjoyed the largest subsidies. Now, over time, the absence of that subsidy will create a level playing field, transferring the benefits of finance to customers and clients. These benefits will accrue slowly over time. Indeed, they may never be obvious to many who don’t recall a different world. That is why it is vital that our sons and daughters are taught not that financial crises are inevitable, but that they are both avoidable and tremendously costly for jobs, growth and prosperity.

The lessons of the crisis need to be learned and handed down to future generations in order that the next phase of reform is sustained. Those reforms have the potential to make finance more effective in serving the real economy. A more diverse financial system can be both more resilient and more effective. If it is structured correctly, each form of intermediation will not be subject to the same risks. Diversity also allows risks to be more closely aligned with risk-bearing capacity in the system. With scope for creditor preferences to be more closely matched with those of borrowers, the full potential of finance to intermediate can be exploited and the cost of finance for the real economy minimised. If we can succeed in safely and sustainably combining bank and market-based finance, the effectiveness of the system can be dramatically increased. Households and businesses can benefit from access to markets while the advantage of banks in originating loans can continue to be exploited.

A trusted financial system can be much more effective. Through cultural change, reforms to compensation and building markets that are transparently fair, finance can earn the legitimacy needed to operate and innovate to serve customers and clients in the real economy. The literature on the benefits of an open global financial system is admittedly mixed. The contradiction between this conclusion and the clear and overwhelming benefits of trade integration is reconciled by the previous unsafe and potentially unstable nature of the global system. As my colleague Andy Haldane observed recently, connectivity can serve as a shock-transmitter. A risky system cannot be an open system.

The renewal of globalised finance must therefore go hand in hand with making the global system safer, including through mutual trust and cooperation between supervisors and regulators. How can
we expect emerging economies to participate fully in an open global system without the confidence that they won’t again be side-swiped by the failure of a large foreign bank? That confidence is growing as we make the system safer. Consistent, full and timely implementation of global standards is necessary to continue to build the cross-border trust on which an integrated system can be founded. Once the safety of the system is secured, the costs of openness will be contained. The road will be clear to secure the substantial benefits of openness in supporting trade and investment.
30 Haldane (2014).

CONCLUSION
The Brisbane Summit marked the point at which the post-crisis system of prudential regulation was settled. That system, built on safer, simpler and fairer foundations than the one that led to disaster is able to serve households and businesses right across the globe.
That we have reached this point is a triumph of the optimists over the world-weary arguments of the pessimists. The mutual trust and co-operation that has allowed authorities to get to this point is a vivid reminder of what can be achieved when countries work together.
But as I said at the outset, just avoiding a repeat of past failures can’t be the height of our ambitions. Having built that level of co-operation it would be a travesty to stop at the foundations.
As I said in Washington three years ago: when bankers were pushing back against our core agenda, in no other aspect of human endeavour do men and women not strive to learn and improve. So onto the foundations we must now build the pillars of diversity, trust and openness that will support a global financial system serving the global economy to its full potential.
Finance is a means to end. It is the real economy that delivers prosperity.
The next phase of reform will give businesses and households the confidence that finance, far from being a threat to them, is here to serve them in their work to deliver prosperity.
Reform should stop only when industry and society are content and finance justifiably proud.
Thank you.
Virtuous Banking

*Placing ethos and purpose at the heart of finance*

*David T. Llewellyn, Roger Steare, Jessica Trevellick*

*Edited by Adam Wildman*

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**Executive Summary**

Now that we are nearly five years into this parliament, there is a tendency to presume that the task of banking reform is now done. But the job is probably best described as half complete. Despite ample reform, it is still the case that many of our small businesses lack the finance they need; customers are bereft of the advice and care they require in order to make sound financial choices; and consumer trust and confidence in the banking sector is at a new low. But why is it, after all this time, do we not have the banking sector we deserve?

It certainly cannot be from a lack of policy activity. Since the Coalition assumed the reins of power, we have had the Independent Commission on Banking Standards, the Financial Services Act 2012, the Financial Services (Banking Reform) Act 2013, numerous Government consultations and the Parliamentary Commission on Banking Standards. Yet none of these have significantly shifted public opinion, nor have they done much to improve the lot of hardup businesses and consumers.

Throughout its programme for reform, the Government has largely focused on regulatory and prudential issues in the name of financial stability. While it cannot plausibly be argued that a systematically stable system is not to be desired, the current approach focuses far too much on this and ignores the crucial root cause of the banking crisis: a calamity that has its origins in the profligate and irresponsible actions of a significant number of bankers and banking institutions, urged on by a banking culture that was at its core fundamentally self-serving. There was on the part of organisations and people, a systemic disregard for the regulatory system, a belief that the pursuit of individual advantage would act for the advantage of all. The banking sector had, in short, lost its ethos. Instead of a culture that prioritised its own self-interest, it should look towards the fulfilment of a broader common good and its wider social purpose.

Given this root cause, it is our proposition that more of the same regulatory and prudential responses to the ongoing crisis in banking will do very little, if anything, to improve the underlying culture of British banking. In order to restore the wider good to its proper place at the heart of banking, we should at first explain what virtue as a goal and ethos as its practice mean. Virtue as a moral theory goes back to Aristotle, and aims primarily at human flourishing. It does not assume that we are all the same and does not, because of this, advocate for the imposition of a unitary, rigid moral regime as most ethical systems do. It recognises that people’s needs are different and, as a result, argues for the flourishing and fulfilment of people in all of their uniqueness.

It is this aspect that makes virtue theory potentially such a good resource for reforming the culture of the banking sector. It argues for the diverse needs of customers but makes a universal claim on the banking industry that means that it should endeavour to cater for all needs and not just for a few. In short virtue in banking is about purpose, it is about what banking is for and why it is needed. With banking, virtue theory allows us to argue for a greater economic and social purpose to banking than is currently postulated.

Character and its formation are crucial to any proper real world development of virtue theory. For character gives a person the strength and resilience to pursue purpose in spite of complexity and
difficulty. To be of good character is to have absorbed moral teaching into ones daily habits and actions. Most ethical systems are formal and empty and they assume that merely following the rules will ensure a good outcome. But virtue theory is about content and the ability to understand the spirit not the letter of the law. Given the failure of rule following ethics as evinced by the crash and multiple scandals, bankers evidently and most obviously need to be of good character. Bankers need to know the good, do the good and be good.

Virtue allows us to reintroduce and restore the notion of good purpose. Banking must go beyond self-enrichment or basic transactional services. It not only performs a clear macroeconomic function, it also has a key role in promoting prosperity and safeguarding the long-term financial interests of its customers. The abandonment of much traditional high street banking has left far too many people without the ‘wrap around’ advice and personal financial planning that they urgently need. This is in part why we save so little and take on so much debt.

So the notion of virtue is not a vague euphemism for carrying on as before – it is a call for the re-introduction of purpose into banking as both an economic need and a moral necessity. Ethos for us is the daily practice of inculcating that purpose into all of the industries’ operations and behaviour. If we achieved that then we would change culture in the industry and re-create a sector that truly served the needs of society. We argue that there are three key areas that policy makers must explore in order to recover virtue and ethos in the banking industry.

The first area to improve is the internal governance structures of the banks. This report argues that it is fundamental to the success of the banking industry that the leadership of banking institutions understand the key social purpose of banking. They must also promote, to the best of their ability, the underlying ethos that a bank needs in order to fulfil this social purpose. In addition to the actions of the banking leadership, all bank employees must, in order to ensure the right culture is inculcated throughout the firm, possess a sense of ownership by taking collective responsibility for their organisations conduct. Finally, beyond collective approaches, there must also be a high level of personal responsibility from all bankers, which should promoted by developing a better sense of professionalism and ethics within the banking industry.

The second area that is need of reform is competition. Various reforms have addressed this already, but for us, competition is about more than just market entry or regulation, as important as they are. Competition can only be considered to be truly effective if it is customer-led, and simple market concentration measures are not an accurate indication of this. Key to this approach is the strengthening of consumer rights, particularly for small businesses. Firms of this size suffer the same disadvantages as individual consumers, but are mostly exempt from much of current consumer legislation. This is an omission we would want to see corrected. Further, we would also like the bankers to adopt a better sense of care for their customers. In particular, we would want them to do more to help their customers plan their finances and offer more bespoke advice that meets their often complex needs.

Lastly, the banking sector must possess significant levels of diversity. This is not the same as competition, which is more about market power dynamics between firms and customers. Diversity is not only the total number of firms within any given sector, but how diverse the range of firms and business models. This is important because all consumers, especially banking customers, have a wide range of wants and requirements that need fulfilling from an equally diverse range of products and services. Such a situation cannot not be achieved by a homogenous banking industry made up of the same plc model. It instead requires the sector to be suitably diverse and varied. With this, this report maintains that the sector must possess a diversity of ownership and business models; a multiplicity of national and local banking institutions; and variety of high street and online platforms to choose from. All of these need to be pursued in order to reach the required levels of diversity.
In short, if we want to place ethos and virtue firmly at the heart of banking, policy makers will need to ensure that there are suitable internal checks on banking institutions through better governance, and that there are adequate external checks on banking behaviour through improved competition and diversity. The ten recommendations below outline how such a programme for reform could be pursed in the next parliament, regardless of which political party assumes power.

1. **Define and enshrine an overarching purpose for banking**: A criticism often levelled at the banks is that they either perform no clear social purpose or, if they do, this is often not reflected in the actions of bankers. This lack of purpose clearly permeates through banking institutions and does little good for the reputation of the industry. In light of this, and the need to solidify the industry around a clear social objective, we recommend that the new Banking Standards Review Council adopt the description of the purpose of banking we advocate in this report. We have based our description of the purpose of banking on three core principles that we believe the industry should always endeavour to adhere to: Ensure systemic prudential security; work for the prosperity of customers; promote the responsible creation of value.

**Governance**

2. **Co-design codes of conduct to place customers at the heart of standards**: Key to instilling the customer-centric culture that banks need are the thoughts and opinions of the customers that will ultimately be most affected by any changes to standards and behaviour. The views of the customer are completely vital to ensure that bankers act in accordance to the high standards members of the public require of them. As such, we recommend that the new Banking Standards Review Council, as one of its first actions, undertake a joint open public and industry consultation to create a Code of Conduct founded on the opinions and desires of all relevant stakeholders, with a prioritisation given to the views of the public.

3. **Require all bankers to swear the Bankers’ Oath**: Consumer trust and confidence is at an all-time low. We believe that, if bankers were required to swear an oath akin to the Hippocratic Oath that doctors affirm, this would signal a serious commitment from bankers towards the pursuit of greater professionalism. In light of this, we recommend that the British Bankers’ Association, the Building Societies Association and the new Banking Standards Review Council ask all of its members adopt the Banker’s Oath as detailed in this report. Such a statement of intent from these three bodies would be a momentous event, and could prove the turning point for how the general public regard our banks.

4. **Toughen shareholder fiduciary duties to promote activism**: A key role of shareholders is to hold the banks they own to account. Yet, shareholder inactivism has been widely acknowledged as one of the key drivers for the last banking crisis. To answer this criticism, we recommend that the British Bankers’ Association conduct a review of shareholder activities in our banks to determine the scale of this inactivism. We would also like to see recommendations that outline how shareholders could have a much more active role in the governance of our large banks. In particular, through improvements to current fiduciary duties that require shareholders to take a much more active role in the stewardship of banking institutions.

**Competition**

5. **Encourage the banks to compete on customer satisfaction**: A truly competitive market is one that competes, not just on price, but on other measures such as levels of customer satisfaction. In order to create a better functioning market, we recommend that the FCA require all large banks and building societies to display customer reviews and ratings on their websites and in their high street branches. The FCA should also display the performances of the leading banks in a league table format to both enlighten the customer and foster competition amongst the banks. The industry should look
to the innovative rating systems that online retailers like Amazon and Ebay use as examples of how such a system might work.

6. **Reclassify small businesses as consumers**: Despite good progress being made in the field of individual consumer rights through the current Consumer Rights Bill, there still exists a lack of commensurate protection for small businesses. Given that small firms are likely to suffer the same disadvantages in terms of limited knowledge and access to professional financial advice as individual consumers, we recommend that the Government adopt a single definition of the term ‘consumer’ that incorporates small firms in future consumer protection regimes. Secondly, we also recommend that the ceiling for Financial Ombudsman Service eligibility be raised to include not just ‘micro’ businesses, but those that are considered ‘small’ enterprises. Raising the ceiling in this way would significantly extend the ambit of this vital body to include thousands of struggling small businesses.

7. **Launch a competition to kick-start the online advice market**: A lack of affordable and sound advice from the banks is an ongoing concern for regulators, and perhaps indicates a failure in their duty of care. Given the ongoing trend in branch closures, the only viable option for providing this advice lies in better online advice. As such, we recommend that the industry run a high level competition amongst the largest banking providers, in conjunction with leading technology firms such as Google and Microsoft, to develop a tool for online advice that empowers their customers to make sound financial decisions. The winning entry should then be actively promoted by Government through the Money Advice Service to maximise the impact of such a tool.

**Diversity**

8. **Conduct an immediate review into the diversity of UK banking**: Too little attention has been given to the contribution diversity makes to the stability of the banking sector. Given the numerous benefits of having a more diverse banking sector, we recommend that the Prudential Regulation Authority immediately conduct a review of the current state of financial diversity in the banking sector. As part of this, and given a lack of good existing data, we recommend that the Government and research bodies also endeavour to improve the quality of data and research available for the assessment of diversity in British banking. This is to ensure that this key component of a healthy banking sector can be sufficiently recognised and monitored by regulators and the academic community.

9. **Localise the British Business Bank through LEPs**: Given the potential benefits that a local banking network could bring to the British economy, we would recommend that the Government build on the formation of the British Business Bank (BBB) to assess how this organisation could be ‘localised’. One possible means of achieving this could be through transforming Local Enterprise Partnerships into local ‘branches’ of the BBB. These would offer BBB products and funded advice similar to a high street bank. Such a move could give England the national tier of local banking that it currently lacks and which most of our European competitors possess.

10. **Utilise public funds to boost the digital finance market**: Innovative online digital finance platforms are leading the way in promoting consumer choice and service excellence. In this digital age, these platforms and vehicles are clearly the future of customer-focused, ethos-led banking. As such, and in recognition of the economic opportunities that a further expansion of digital financial services could bring, we recommend that the Department for Business, Innovation and Skills conduct a review to determine the viability of utilising local government funds to increase lending to small businesses and social enterprises through digital lending platforms. By way of example, Funding Circle already operates a similar scheme with a number of local authorities, and has met with some success.
By adopting these ten recommendations, we believe that the banking industry can be made to be much more responsive to the needs of its customers and the country in which it operates. By instilling a culture in banking that promotes behaviours that strive towards the common good, we believe that consumer trust and confidence will increase and bank customers will get the service they need and deserve.

The Report’s Key Recommendations:
1. Define and enshrine an overarching purpose for banking
2. Co-design codes of conduct to place customers at the heart of standards
3. Require all bankers to swear the Bankers’ Oath
4. Toughen shareholder fiduciary duties to promote activism
5. Encourage the banks to compete on customer satisfaction
6. Reclassify small businesses as consumers
7. Launch a competition to kick-start the online advice market
8. Conduct an immediate review into the diversity of UK banking
9. Localise the British Business Bank through LEPs
10. Utilise public funds to boost the digital finance market
I’d like to start by congratulating ResPublica for publishing this excellent report on Virtuous Banking. It will be required reading for banking leaders and policymakers. And its recommendations, I am sure, will be high on the agenda of the new Banking Standards Review Council as it gets up and running later this year.

This is a subject I’ve been thinking and talking about a lot over the past 10 months. So I would like, if I may, to use my time today to give my views on this publication. I’ll group them under three headings. The first category is – brilliant. I will highlight the ideas and recommendations that hit the button for me, and I am keen to take forward. Some are still a bit rough round the edges, but the shape and direction seem to me to be spot on.

The second category comes under the heading of “debatable”. These are suggestions that I would expect the BSRC to think about seriously, but which may or may not be on the right track. And the third category on my list is – “needs more work”. By this I mean issues which have been raised in the document and are important, but which need more attention. One of these issues in particular covers an area which the three authors of this publication are particularly well qualified to take on.

Let’s start off with the “brilliant” category.

The first recommendation in the report is that banks need to be much clearer about why they are in business. They need to define their sense of purpose. That is exactly right.

In his report on Barclays, Anthony Salz argued that in the years leading up to the banking crisis, the bank’s sense of purpose – its very reason for existence -- came to be a determination to maximise the return on equity over the short term.

Barclays was by no means alone in this approach, which I believe was a prime cause of the industry collapse in 2007-08.

We see just the latest example in today’s newspapers. Lloyds traders did not personally benefit from manipulating the repo rates used to calculate fees on the Bank of England’s liquidity lifeline. But they appear to have lived and worked in a culture where such behaviour did not, at least to those actually involved, seem out of the ordinary in the name of profit maximisation.

There is plenty of room for debate about the purposes of a bank. Are they there to maximise returns to shareholders? Or are they, at the opposite end of the spectrum, public utilities? The answers will lie somewhere between these two extremes and will probably vary from institution to institution. In other words, the purpose of a big high street retail bank may well be rather different from that of a wholesale bank with little or no interface with the public.

“Virtuous Banking” draws its ideas from the three core principles it believes the industry should strive to achieve, and which surely apply across the whole sector: These are to ensure systematic prudential security; work for the prosperity of customers; promote the responsible creation of value.”

Those principles look sound. But there is room for debate about the conclusion drawn from them in the report about the purpose of a bank which, it says, must be “to provide security and prosperity for its customers, and to enable the flourishing if their communities in a manner that is responsible and creates shared value for society.”
I think I would like to see the word “sustainable” in there somewhere. Banks have to make profits if they are to provide good services to their customers over time. And the level of profit required will vary from institution to institution, depending on the riskiness of its business. But this is just quibbling.

In big picture terms, I think the report is absolutely right to emphasise the need for a clearer understanding of what the central purpose of bank ought to be. A second area where I’m in complete agreement with the report is in its discussion of ethos and the need for virtuous banking. The argument here is that ethics in all sectors of the economy is about promoting decisions and behaviours that are guided by values that go beyond a company’s legal; requirements. It must, if it is to be effective, apply to all aspect of business conduct at all levels of the firm.

The report warns against an approach that is based on a compliance and obedience philosophy, and argues that values must be firmly embedded within banks such that they lead to a shift in actual behaviour and are tangibly demonstrated by the employees in their daily work. This goes to the heart of what the Banking Standards Review Council is all about, and picks up on the themes articulated by Mark Carney, Governor of the Bank of England, in his speech on inclusive capitalism earlier this year.

“Integrity,” he said, “can neither be bought nor regulated. Even with the best possible framework of codes, principles, compensation schemes and market discipline, financiers must constantly challenge themselves to the standards they uphold.”

It’s that thinking which explains his strong support for the work of the BSRC, which he sees as an important sign of banks’ recognition of the need for change.

It’s clear that there are limits to what can be achieved by regulation and the law. What the ResPublica report is saying, it seems to me, is that it’s not enough to ask the questions: “Is it profitable and is it legal?” The third and critically important question is: is it right – and that’s something that can only be shaped by individual institutions, and at every level of the organisation. I am all in favour of robust regulation. But as Roger Steare has argued:

“At their worst, laws, regulations and red tape have a tendency to multiply, because they remove our responsibility for deciding what’s right”.

That, by the way, is a main reason why the Financial Conduct Authority is supportive of our plans for the BSRC. The alternative to our success, it can see, is death by rule book. Regulation also has a tendency to introduce complexity into the system – and complexity can be gamed by market practitioners. There is no better example of this than the SEC’s ruling on centralised pricing for share prices which, as brilliantly described by Michael Lewis’s book Flash Boys, created a gold mine for high frequency traders in the US. Virtuous Banking strikes another strong chord when it argues that executive development in the banking sector has focused too much on training technical competencies and command and control management skills.

I’ve felt this very strongly in my work over the past few months. Too often, people aren’t encouraged to look at the big picture. They complete their slice of a project in a technically satisfactory fashion, and then pass it down the line to the next stage of the process without challenge on the way. What is needed is a significant shift in the culture of leadership to one that promotes moral purpose, character, critical thinking and challenge. Virtuous Banking also makes the case for what it calls a system of customer led peer review, which it sees as a way of incentivising banks to be more innovative with their products and services, and of encouraging increased competition within the sector.
For similar reasons, the BSRC will be asking banks to report to the public under a number of relevant headings, covering the behaviour and competence of their employees, and the outcomes for customers. It would be great if the authors of this report felt able to encourage and steer us as we seek to develop relevant metrics.

Let me turn now to those proposals in the report that I’ve labelled as debatable. As I’ve said, I’m sure the BSRC will want to consider these ideas. But for me, at least, they don’t automatically ring a bell.

Top of this list is the idea that has caught the headlines today, and that’s the recommendation that all bankers should be required to swear a Banker’s Oath. In the words of the report, “We believe that, if bankers were required to swear an oath akin to the Hippocratic Oath that doctors affirm, this would signal a serious commitment from bankers towards the pursuit of greater professionalism.”

They’ve done it in the Netherlands. Why not in the UK?

Here’s my concern with this idea. It starts with the question that took up a lot of the Parliamentary Committee’s time: is banking a profession, in the same way as the law, accountancy or medicine? The Commission concluded that banking involves a wide range of activities and lacks the large common core of learning which is a feature of most professions. In its words, “It’s a long way from being an industry where professional duties to customers, and to the integrity of the profession as a whole, trump an individual’s own behavioural incentives.”

I think that judgment is correct – and that is the problem with a banker’s oath. Several hundred thousand people call themselves bankers in the UK. They have no common qualifications – many have no qualifications at all – and most of them have little or no processes for self-discipline. If bankers want to take an oath – and I know that some do – I say good luck to them. But speaking personally, I think this should come at the end of the process, rather than at the beginning.

In other words, establish the robust framework that’s required for a professional body, like the General Medical Council or the Law Society, and then think about imposing an oath. If you do it the other way round, it could just turn out to be hot air. But that shouldn’t be the end of the matter. Let’s debate the idea some more. Another area of the report which needs more debate is the suggestion that bankers should be encouraged to bring their personal humanity to the work place, and apply it accordingly. Of course you have to approve of that idea. But it fails to recognise, I would suggest, the extent to which the norms of behaviour in the banking sector shifted during the long prosperous years that lead up to the crash.

What might have seemed unacceptable in year one of the upswing could well have been become standard practice by year ten. A culture of entitlement developed. As Warren Buffet once pointed out, “The five most dangerous words in business are ‘everyone else is doing it’.” Hauling back on these attitudes will be complex and will take time, and a different style of leadership.

So on to my final category of observations, which comes under the heading – “needs more work”. I have three suggestions.

The first and most obvious is that the ResPublica report focuses heavily on retail banking, and gives little attention to the wholesale and investment banking businesses. I think this is a weakness.

In a number of respects, I think the really big challenges when it comes to placing ethos and purpose at the heart of finance lie in the wholesale banking business.
Of course lots of things went wrong on the retail side – but I would suggest that they are much easier to fix than the shortcomings that have shown up elsewhere.
A lot of the problems in retail stemmed from top down directions to achieve sales targets that could only be met by putting clients’.

The Financial Conduct Authority reported in the spring that all the major high street banks had changed their approach to sales targets for the better. It may be no coincidence that a survey of consumers’ trust in their banks published by Accenture earlier this month showed that although the level was still abysmally low, it had actually risen from 43 per cent in 2012 to 52 per cent this year. You won’t change behaviours on the wholesale side simply by changing the tone from the top. This is likely to become all too depressingly apparent in the coming months as the foreign exchange saga starts to unfold. It’s likely to show that bad things were going on well after the LIBOR scandal had been exposed.

In these circumstances, it’s not really credible to suggest that the pathway to virtuous banking in the UK lies only through the retail side.
A second area where I suggest more work would be helpful comes in the discussion about the contribution diversity makes to the stability of the banking sector. The report makes a very strong case for the benefits to be derived from having different forms of ownership, And a greater variety of structures within the British banking system.

To take just one example, the economist Adam Posen argued persuasively during his time on the Monetary Policy Committee that a big shortcoming of the financial system in the UK is that it does not have a spare tyre for the provision of capital to non-financial business when the banking system has pooped a leak. By this he meant that compared with other rich economies there were very few alternative sources of money outside a small number of rather similar banks. But I think ResPublica rather cops out on this issue with its call for an immediate review into the diversity of UK banking to be conducted by the Prudential Regulatory Authority. Isn’t that a job for a radical think tank? And don’t we need it done much more quickly and boldly than a regulator is ever likely to deliver? This is bound to be an issue in next year’s General Election – we need ResPublica itself to get us all thinking about this one.

On to my final suggestion for more work, and this is the one where I think the authors of this report, David Llewellyn, Roger Steare and Jessica Trevellick have so much to contribute. They argue brilliantly well the case for placing ethos and purpose at the heart of finance. But for my money, they don’t give quite enough space to the practical processes that need to be undertaken to make this happen.
We know you can’t teach ethics as if it were a foreign language. But how best to share good practice and shared values across very large organisations? Who does it well, and what can we learn from other industries?

I know what doesn’t work – for example, the on-line training schemes on ethics that I’ve seen offered by a number of banks. The screen tells you it will take you 30 minutes to pass your test on money laundering, and you set out to do it in 15.
But what’s the better way?
I’m sure the BSRC, when it gets up and running in the next few months, would love to work with you in answering that big question.
To conclude, this is a stimulating piece of work that makes a valuable contribution to an important debate. It doesn’t have all the answers, but it’s something think we should all welcome. Let’s talk some more!
The Future of Banking: Restoring trust and confidence in the financial sector

Full day conference, call for partners

By David Fagleman, Elliott Mears

Building on the success of our recent publication 'Virtuous Banking: Placing ethos and purpose at the heart of finance', ResPublica is planning to host a full day 'thought leaders' conference entitled 'The Future of Banking: Restoring trust and confidence in the financial sector'.

Described as ‘required reading for policy-makers’ and ‘full of brilliant ideas’ by Sir Richard Lambert, Chair of the Banking Standards Review Council, the conference will expand on Virtuous Banking report and explore several themes which we believe need to be developed in order to restore virtue to banking and finance and create a sector fit to serve the diverse needs of both personal and business customers.

The financial sector has come to be typically perceived as a purely profit-seeking and self-serving industry that prioritised its own needs over the customers it purported to serve. While the creation of profit is fundamental to business, it should not always be the primary concern of success. Indeed, the creation of profits and meeting the wants and needs of consumers are not mutually exclusive.

Instead of a culture that merely prioritises its own self-interest, what is needed is a culture that looks toward the fulfilment of a broader common good. In order to achieve this, we advocate the restoration of virtue as the central guiding principle in the financial sector. By this, we call for the re-introduction of a broader purpose that establishes banking and finance as central to both the economy and society, as the sector should ultimately aim to enable economic and social prosperity and promote human flourishing. This will not only benefit the consumer, but restore trust and confidence in the financial sector; a necessity for its future.

Taking place early next year the conference will hear from leading politicians, policy makers, academics and practitioners, and will set out the policy innovations and challenges necessary to create a financial sector that truly serves the needs of its customers. The conference will form a central part of ResPublica’s new ‘Virtue Programme’, which calls for a cultural renewal that instils virtuous habits into the heart of society that will deliver the type of social and economic change we need.

For more information or to discuss the opportunity to partner with ResPublica on this project, please contact David Fagleman, Researcher, ResPublica david.fagleman@respublica.org.uk

Good Culture considers the mechanisms which could be used to improve business behaviour in the UK’s financial services sector. There are strong reasons for worrying about the behaviour and culture of the British financial sector. Short-termism, poor risk management and a lack of strong corporate governance have all been identified as sources of the financial crisis and continue to cause concern about the stability of the UK’s economic recovery.

The financial sector’s scandals are not isolated incidents but examples of a systemic problem. Regulation can only go so far to stamp out bad behaviours and a change of corporate culture is sorely needed if the financial services sector is to become a blessing not a burden for the UK economy.

Based on a specially-commissioned consumer survey and interviews with financial services firms, Good Culture considers the mechanisms which could be used to improve business behaviour in the UK’s financial services sector. This report examines how competition, stronger corporate governance and more diverse ownership structures could help develop a better business culture, providing the financial services industry with the resilience and security needed to support the rest of the economy.

British consumers want better business behaviours in financial services and would be willing to switch provider to get it, according to exclusive polling in a new report from think tank the Social Market Foundation (SMF).

Good Culture: Does the model matter in Financial Services? explores consumer views of company behaviour by financial services firms and how this affects who they choose to do business with. New polling for the report, conducted by Populus, show that nearly two thirds of consumers (64%) would switch providers if their current financial services company was involved in bad business behaviours, while four out of ten (41%) would be willing to switch specifically to find a provider who behaved in a more ethical way. It also reveals that the public believe nearly two thirds (60%) of
financial services companies continue to take big risks after the financial crisis, while 72% of firms are seen as putting shareholders and profits before customers, and 69% are viewed as putting pressure on staff to sell certain products or behave in ways which are not in the customer’s best interest.

The SMF’s findings show that six in ten consumers (60%) believe that ownership structures can make a difference to the way financial companies act. Customer owned mutuals (79% of consumers likely to trust) top the polls of the financial services business types consumers are likely to trust. While consumers believe that customer owned businesses are most likely to engage in good business behaviours, the dominant shareholder owned PLCs are seen as the least likely to create strong corporate cultures.

However the SMF found that, despite their stated preferences for certain business ownership types, the average member of the public can only successfully recognise the ownership model of two of the UK’s 15 largest financial services companies.

To help create clarity for customers, greater competition and better culture across the financial services sector, the report recommends:

Establishing a ‘Good Culture Kitemark’ to be awarded to financial service products provided by firms that exhibit good corporate behaviour. The Kitemark would allow consumers to understand at a glance how financial service providers perform against a broad set of standards above and beyond the requirements of regulation which financial services providers could sign up to.

Level the playing field for different business models to increase diversity in ownership. Making life easier for non-PLC models in the UK would help to boost diversity in the financial services sector, improving both the industry’s resilience and that of the economy as a whole. Providing an explicit remit to support diversity as well as competition in regulators’ mandates.

Reducing the deposit guarantee limit to £30 000. At present, consumers’ motivation to switch financial services providers on the basis of behaviour is dulled by substantial deposit guarantees. A lower deposit guarantee limit would continue to cover more than the average household’s annual income, a 10% deposit on the average cost of a house and the median gross financial wealth of UK households, but would provide a signal that consumers can be affected by the behaviour of financial services firms and should take this into account when choosing providers.

Financial mutuals should be provided with access to appropriate capital instruments. Survey evidence suggests that the implementation of a Good Culture Kitemark scheme would encourage consumers to seek out mutual providers of financial services. At present, however, these firms are limited in their ability to expand by access to capital. A range of suitable instruments should be made available so financial mutual of all sizes can access capital markets, while maintaining their mutual character.

Commenting on the findings, SMF economist and report author, Katie Evans said:
“It is clear that there is a significant lack of trust in much of the financial sector. Consumers don’t believe all financial services firms are involved in negative practices, but they struggle to identify companies who they think are more likely to meet their expectations.”

“Consumers need better information about business behaviour in financial services firms to help them identify firms with good corporate cultures. We believe that a Good Culture Kitemark scheme could play an important role in helping financial services firms find a business case for better behaviour.”

In response the report, Mark Austen, LV-Chairman said:
“Our belief is that mutual ownership is supportive of a virtuous circle and much of our success is down to our model as it enables a culture ensuring we always act in the interests of our customers. Our fundamental values exist to support our customers and members, employees, and the communities in which we operate. Our view is if we look after our people, our people will look after our customers and as a consequence we increase long term value for our members.”

CHAPTER 5 - CONCLUSIONS

Corporate culture plays a vital role in determining behaviour in financial services firms, where complexity means regulators and managers cannot anticipate every opportunity for transgression. By creating norms of good behaviour, financial services firms can improve the likelihood of their long-term stability and success. And given the sector’s crucial role in the economy, this will also benefit both consumers and businesses alike.

Customer-owned mutuals are predisposed to good corporate culture, thanks to the coincident interests of owners and customers. Member ownership reduces the pressure on firms to make profits, which can lead to excessive risk taking, and instead provides a basis for the sustainable provision of financial services. Making life easier for financial mutual in the UK would help to boost diversity in the financial services sector, improving both the industry’s resilience and that of the economy as a whole. Providing an explicit remit to support diversity as well as competition in regulators’ mandates, wider access to appropriate capital instruments and a commitment to disinterested demutualisation could help to protect the UK’s remaining financial mutuals and help them to thrive.

The financial crisis and scandals since have damaged consumer confidence in financial services firms. But by highlighting instances of good corporate culture, this could provide an opportunity to instill competition along the axis of business behaviour. Although consumers currently struggle to identify good business behaviours among financial services firms, the provision of simple, easy to navigate information through a Good Culture Kitemark and scoring system could help consumers make their preference felt by financial services firms. While customers should be protected against the worst behaviours of financial services providers, giving them an incentive to care about culture by reducing deposit insurance could also provide a significant incentive for better behaviour across the sector. These reforms could help improve the visibility of corporate culture, but they will also require a renewed commitment to strong corporate governance. Effective oversight, accountability, compliance and risk management will remain crucial to the stability of a sector where perverse incentives and information asymmetries mean temptation is ever-present.

Incentive schemes which provide collective responsibility for corporate behaviours should help to ensure that it is always in the interests of individual employees to behave well. We cannot completely remove opportunities for bad behaviour in the financial services sector, so we must ensure that good behaviour has its own reward.

Developing good culture in financial services will require more than a statement of intent, an advertising campaign or a quick mention in employee training. To create new norms of better business behaviour will require constant vigilance and oversight. We hope to make this task easier by encouraging consumers to play a role, providing financial services firms with an immediate and impelling reason to commit to improving behaviour. Over time, this, together with the other recommendations made in this report, could help to create a stronger, more diverse and competitive financial services sector, and ultimately a more resilient economy to the benefit of us all.
Clifford Longley - Just Money: How Catholic Social Teaching can Redeem Capitalism

October 2014

Can we just go on with business as usual? The banking crash and ensuing global recession revealed deep problems with free market economics. Yet after five years of economic instability and falling living standards, market fundamentalism – the conviction that market forces should be interfered with as little as possible – is somehow still standing with no serious rivals in the frame.

In this essay, respected journalist and commentator Clifford Longley points to a way forward. With the long-standing and highlyesteemed model of Just War theory in the background, he unpacks the theory of Just Money. Drawing on the extensive and detailed tradition of Catholic Social Thought – a tradition with roots in classical philosophy and Catholic teaching that is accessible to people of all faiths and none – Longley sets out an alternative vision.

The answer is not to abandon the business economy but to humanise it, thereby making it fairer, more efficient and user-friendly, never forgetting that, like the Sabbath, the market was made for man and not man for the market.

Neoliberalism is the “heresy of our age” and should be replaced by a “Just Money” approach to economics as laid out by the Catholic Church, according to a new report backed by senior MPs on both side of the political divide.

The report, commissioned by Theos, the religious and society think tank is launched as the Archbishop of Canterbury meets the heads of the International Monetary Fund (IMF) and the Bank of England in Washington. IMF President Christine Lagarde and Bank of England Governor Mark Carney have previously voiced concerns at the growing gap between the rich and the poor.

Written by Radio 4’s Moral Maze contributor and author Clifford Longley, Just Money puts forward an approach to economics which takes its inspiration from the Catholic Church’s highly-respected Just War theory, which inspired papal opposition to the Iraq War of 2003.

The report is being backed by senior political figures such as Jon Cruddas, Jesse Norman, Maurice Glasman and Jo Johnson. It argues that politicians and economists are sliding back to the “neoliberal” consensus that caused the 2008 crash and that instead they should draw on the tradition Catholic Social Teaching (CST) on economics, as advocated by Pope Francis and his predecessors.

Up to $30 trillion was lost in the run up to the 2008 crash. In a controversial document last year the Pope strongly criticized the “crude and naïve trust” in those wielding economic power. Instead of the traditional binary model of market and state, CST, as laid out in writings by Pope Benedict and Pope Francis proposes a triangle of forces: state, market and civil society.

“Catholic Social Teaching is not anti-business, but pro-human,” says Longley. “It offers a coherent set of principles that can protect social capital – shared values and standards such as honesty and trust. In the long run this must be good for business as well as good for ordinary people.”
Just Money goes beyond the usual left-right divisions in economics. What we need, the report argues, is to set aside traditional economic theories of labour or capital, and re-examine what economic activity is actually for.

Senior economic figures have been taking the Pope’s views increasingly seriously. In May Ms Lagarde, cited Pope Francis in a speech on “inclusive capitalism”, echoing his phrase that inequality is the “root of social evil”. Speaking at the same event, Mark Carney, who regularly attends Mass, said business needed to be seen as a vocation and argued that market integrity was “essential” to fair financial capitalism.

“The answer is not to abandon the business economy,” Longley writes, “but to humanise it, thereby making it fairer, more efficient and user-friendly, never forgetting that, like the Sabbath, the market was made for man and not man for the market.”

Politicians from both left and right have supported the report. “This is a fantastic piece of work and very significant,” says Jon Cruddas, MP. “This space is a key one for the future of politics.” “The report convincingly shows how market fundamentalism can destroy trust and undermine civil society, and reminds us how both trust and civil society are needed for the renewal of capitalism,” adds Jesse Norman, MP.

[final chapter] Neoliberalism versus the common good

Few would disagree that the promotion of “integral human development” of everyone on the planet was a worthy aim; or that the “full human dignity” of every person ought to be respected. Few would disagree, also, that these are values we share and ought to be committed to, as far as we are able – in other words, they are our “common good”. It follows that every economic system or theory that offers itself for our approval ought to be submitted to the simple test: does it foster these basic human values, or hinder them? What does it say about the common good? Those are the criteria supplied by Catholic Social Teaching to this debate.

Neoliberalism undoubtedly has the capacity to generate great wealth, but it also has, as 2007-2008 manifestly demonstrated, an even greater capacity to destroy it. It also appears to have a strong tendency to reward the wealthy – those who already have capital – without an equal tendency to reward those whose contribution to the creation of wealth is through their work. That inevitably creates tensions that are in opposition to the common good. They weaken the cohesion of society by undermining trust. They advertise all too loudly that we are not ‘all in this together.’

The dangers inherent in growing inequality were highlighted in Christine Lagarde’s address to the Inclusive Capitalism conference already mentioned. She said:

The principles of solidarity and reciprocity that you see celebrated in many encyclicals from Leo XIII to our Pope Francis that bind societies together are more likely to erode in excessively unequal societies. Pope Francis recently put this in stark terms when he called increasing inequality ‘the root of social evil’. There is a natural tendency for governments, on seeing businesses operating without internal constraints, with all the danger to the common good that that brings with it as 2008 showed, to make good the deficiency by imposing binding external constraints – regulations. Hence neoliberalism breeds the expansion regulation, almost to the same degree that it hates it. The regulatory burden generates costs which lower efficiency and reduce profits. But it has another, more insidious effect. Regulations crowd out virtue. Business persons who might well want to conduct their affairs in accordance with the common good get no credit for it.
Instead, their only goal becomes ‘compliance’. Instead of asking ‘Is this right or wrong?’ they are required to ask ‘Is this within the rules or not?’ And they are likely to have to ask that of other people rather than themselves, as compliance turns on legal interpretations and past precedents which require specialist knowledge that is continuously updated. Increasing regulation inevitably undermines the very standards the regulations are designed to police. Though they are meant to restore trust, in practice they destroy it.

An economic system which answers to the common good, in other words which accepts internal moral restraints on its ability to make profits, would be more trustworthy and actually require less regulation. It would generate those moral restraints itself, because it would have an internal structure and culture that was infused with moral and ethical principles – and, in doing so, would be more, not less, efficient.

You might well ask where it would get these principles from, and the answer appears to be from the background values of society at large, from civil society – the space where most of us spend most of our lives. That includes, of course, the most important generators and custodians of moral values within civil society, who are the creators of the particular form of wealth called moral capital – namely the churches and other institutions of religion, which devote themselves to the worship of God and to asking themselves the great question, the only one that matters to them: how does God want me to live my life? The moral capital they protect and generate – primarily visible in the form of trust – is just as important to the success of businesses as the physical capital they need – money. To quote Christine Lagarde again:

The behaviour of the financial sector has not changed fundamentally in a number of dimensions since the crisis. While some changes in behaviour are taking place, these are not deep or broad enough. The industry still prizes short-term profit over long-term prudence, today’s bonus over tomorrow’s relationship. To restore trust, we need a shift toward greater integrity and accountability. We need a stronger and systematic ethical dimension.

Lagarde offers what is almost a definition of the common good as it relates to the goals of financial sector:

Its goal is to put resources to productive use, to transform maturity, thereby contributing to the good of economic stability and full employment – and ultimately, to the wellbeing of people.

Is Catholic Social Teaching “the better way” that Alan Greenspan dreamed of as he surveyed the wreckage of neoliberalism in the aftermath of 2008? Does this analysis address the flaws in the neoliberal system? Would these reforms restore trust, remove sources of instability, and make businesses more sustainable long-term? Would markets function better? Are the adjustments required in the way business and the economy works feasible and realistic? Are they politically do-able? And more fundamentally, would a post neoliberal market economy as described here make for a fairer, more vibrant and more prosperous economy and a happier and more fulfilled population? We believe we have given adequate grounds for answering all those questions in the affirmative.
NVB Jubileumcongres 2014

Hoe ziet de bank van de toekomst eruit?

Die vraag stond centraal op het NVB jubileumcongres

Terugblikken, maar vooral vooruit kijken. Dat was het devies op het symposium in theater De Meeravart in Amsterdam op 2 december. NVB-voorzitter Chris Buijink wees in zijn introductie op de transformatie bij de banken in de laatste jaren. “De crisis is een waterscheiding tussen bankieren gefocust op globalisering, schaalvergroting en aandeelhouderswaarde én bankieren midden in de samenleving.” Nederlandse banken lopen hierbij voorop in Europa, aldus Buijink. Dat het de banken menens is bij het bewerkstelligen van een cultuuromslag, blijkt uit initiatieven als de Code Banken, het Maatschappelijk Statuut en de gedragsregels voor Toekomstgericht Bankieren. De sector neemt bovendien het voortouw bij de introductie van de bankierseed en tuchtrecht voor iedereen die bij een bank werkt. “Cultuur en gedrag zijn een zaak van álle medewerkers van banken in Nederland.”

‘Zachte’ normen

Minister Jeroen Dijsselbloem (Financiën) toonde zich in zijn toespraak tevreden dat alle grote Nederlandse banken geslaagd zijn voor de Europese stresstest. Toch is er volgens hem geen plaats voor zelfgenoegzaamheid. “Banken moeten beseffen dat de buitenwereld sceptisch is. Wie dat nu nog niet begrijpt, heeft geen toekomst in de bankenwereld.” Voor de minister zijn de navolging van het nieuwe beloningsbeleid en de afwikkeling van rentederivaten voor mkb’ers belangrijke testcases. “De bewijslast ligt bij u.”

Dijsselbloem spoort de sector aan om naast stabiliteit ook aandacht te hebben voor ‘zachte’ criteria als vertrouwen, reputatie en cultuur. “Ik zie veel goede voornemens in de bancaire sector en de wil om de banken echt te veranderen. Daar wil ik graag aan meewerken.” De komst van een jongere generatie bankiers geeft volgens de minister een impuls aan de vernieuwing binnen de sector. Ook vindt hij het positief dat de NVB het jubileum aangrijpt om de dialoog aan te gaan over hoe het in de toekomst beter kan.

Prikkelende stellingen

Daarna was het de beurt aan deskundigen en stakeholders om met elkaar in gesprek te gaan. Merel van Vroonhoven (AFM), Fried Kaanen (Koninklijke Metaalunie), Bart Combée (Consumentenbond) en Rien Nagel (Rabobank) gingen in de eerste ronde in debat over ‘de bank van de toekomst’. Gespreksleider Diana Matroos hield hen enkele prikkelende stellingen voor, waarover ook het publiek in de zaal kon stemmen en zich via smartphone uitspreken. Daar werd volop gebruik van gemaakt en dat droeg bij aan een levendige discussie.

Stelling: Aandacht voor cultuur en gedrag is een voorwaarde voor Toekomstgericht Bankieren.

Het publiek in de zaal onderschreef deze stelling vrijwel unaniem (97%). Van Vroonhoven stelde dat banken druk van buiten nodig hebben om te veranderen. “Goede voornemens zijn niet genoeg, de crux is dat je de gewenste verandering geïmplementeerd krijgt.” Ze wees erop dat een cultuuromslag door alle geledingen van de bank moet worden gedragen. “Dat vraagt om vers bloed in de organisatie.”

In de discussie was veel aandacht voor de paradox dat consumenten en bedrijven over banken veel negatiever oordelen dan over de eigen adviseur of individuele producten en diensten. “Mijn bank deugt niet, mijn adviseur wel”, zo vatte Nagel het samen. “Het kost tijd om een grote instelling als een bank te veranderen. Klanten zien daar nu nog onvoldoende van terug. Er is dus nog veel werk aan de winkel.”
Stelling: Bankkantoren zijn in de toekomst overbodig; alle dienstverlening gebeurt online.

Spanningsveld
In de tweede ronde gingen hoogleraar Arnoud Boot (UvA), ondernemer Annemarie van Gaal, Gerjoke Wilmink (Nibud) en Koos Timmermans (ING) in debat over ‘de uitdagingen van nu’. De aandacht ging daarbij vooral uit naar het belang van innovatie en het spanningsveld tussen de commerciële belangen van banken en de wil om dienstbaar te zijn aan de klant.

Stelling: De bankierseed draagt bij aan het herstel van vertrouwen in banken.
Slechts 39% van de aanwezigen was het daarmee eens. Timmermans: “Dat verrast me wel. Met de bankierseed geeft de sector aan hoe ze zich wil gedragen en waarop klanten en andere betrokkenen ons kunnen aanspreken. Dat maakt ons kwetsbaar en laat zien dat we het menen. Natuurlijk moeten banken dat ook in de praktijk laten zien. Maar de eed kan zeker bijdragen aan de cultuuromslag in de bankensector.”
Volgens Boot blijkt uit de uitslag vooral dat voor het publiek nog onvoldoende duidelijk is waarom de eed wordt ingevoerd. “De bankierseed betekent dat elke bankmedewerker een eigen, individuele verantwoordelijkheid heeft om in het belang van de klant te handelen en zich niet kan verschuilen achter een leidinggevende. Iedereen die bij een bank werkt heeft de plicht om misstanden te melden. Leg je het zo uit, dan denk ik dat de meerderheid het wél met de stelling eens is.”

Stelling: Een bank moet vaker dan nu ‘nee’ zeggen om de risico’s die zij loopt te beperken.
Een kleine meerderheid (56%) was het met die stelling eens. “Wat mij betreft zou de bank vaker nee moeten zeggen om de risico’s voor de klant te beperken”, reageerde Wilmink. De normen die budgetorganisatie Nibud berekent voor het verstrekken van een hypotheek zijn wat haar betreft een richtsnoer voor het leveren van maatwerk. “De bank moet steeds bekijken of de lening bij die specifieke klant past en de woonlasten verantwoord zijn.”

Na een middag vol boeiende discussies was het slotwoord aan NVB-voorzitter Buijink. Hij benadrukte dat de banken de dialoog met de samenleving blijven aangaan. Dat is ook van belang, want uit de afsluitende stelling bleek dat een grote meerderheid (78%) vindt dat de banken het contact met de samenleving nog niet hebben hersteld. Buijink: “Wij voelen de verantwoordelijkheid het vertrouwen terug te winnen. Dat is onze opgave”.


Nederlandse Vereniging van Banken 2014

Future-oriented Banking

Social Charter
Banking Code
Rules of Conduct

Introduction: an industry in flux

Banks are not ordinary businesses. Our customers—and society as a whole—must be able to count on stable, service-oriented and reliable banks. Consequently, it is essential that banks, individually and as an industry, pursue a balanced and recognisable course. A course that is not determined unilaterally by a single interest but which is based on the balanced interests of all stakeholders (customers, employees, shareholders, other providers of capital and society as a whole).

Banks’ functioning is quite properly a significant subject of public debate, since we all have to deal with banks. It makes sense to avoid governments having to intervene in the future to guarantee the continuity of banks and the financial system. Real steps have been taken since 2008 to ensure that the bill for excessively risky conduct by players in the financial system no longer lands on taxpayers.

The banking industry is working on an unprecedented change process. Since the financial crisis broke out in 2008, there has been hard work at many levels—by legislators, by regulators and certainly also by the banks themselves—on a more stable and less risky financial system. The core social function of banks, attracting savings and deploying them in the real economy through investment and loans to consumers and businesses is to the fore in this.

Although individual banks are making individual changes, there are a number of clear trends: institutions with international operations are focusing more on their home market(s), balance sheets are contracting, buffers are being strengthened, the range of products and services is being simplified, great emphasis is being put on tightening risk management, banks’ remuneration policies are being moderated and customers’ interests are specifically being made central.

But we are not there yet. The public debate also addresses the role of banks in society: what banks can contribute to financing businesses, large and small, the functioning of the housing market and wider public projects such as sustainability in energy supplies. At the same time, the reality is that trust in banks is still low and their actions are watched critically. Public trust in banks can grow again as a result of, among other things, transparency, customer focus and integrity.

Much has been done but there is still a lot to do. There are no simple solutions to the challenges that face the industry: time is needed, including to ensure that the right culture of service-oriented, sustainable and ethical banking is internalised. This demands effort by the industry as a whole and by individual banks in particular. The move to greater stability and less risk is, however, irreversible.

It is, therefore, a question of finding a new balance. This cannot be a one-sided process. We are part of society and also want to conduct the conversation on the role of banks with our customers and anyone who feels involved in the struggle for a stable, service oriented and reliable industry. Much can still be gained simply from that dialogue with the community. Banks should accept their social responsibility in that respect and contribute to resolving social issues, to the extent the financial preconditions and regulations allow it.

The report (2013) of the Committee on the Structure of Dutch Banks (the ‘Wijffels
Committee’) laid significant foundations for the further strengthening of Dutch banks. It paid great attention to the stability of the industry and the importance of competition and diversity in Dutch banking. The committee also called on banks to set out the role they want to play in society in a social charter. The Dutch banks are keen to pick up this gauntlet.

By introducing a Social Charter, updating the Banking Code and implementing a bankers’ oath (with the associated rules of conduct and disciplinary system) across the board, we want to demonstrate what we stand for and what we want to be held accountable for in the ongoing renewal process: as individual banks and as an industry at the heart of the community.

The Social Charter, the Banking Code and the rules of conduct associated with the bankers’ oath together form a package called ‘Future-oriented Banking’. The Social Charter describes the (preferred) position of the sector as a whole in society and the shared values of the sector. The Banking Code safeguards sound administration at every bank and the rules of conduct make the responsibility of every individual employee at the bank explicit. These building blocks visualise the way in which the sector wishes to achieve an ethical, customer-oriented and sustainable sector. The package is endorsed by all members of the Netherlands Bankers’ Association. Compliance with the rules set out in the Banking Code and the rules of conduct is however limited to banks who have their registered offices in the Netherlands. Foreign banks comply with the regulation and self-regulation in the country of origin.

1 Social Charter

The Netherlands is still a prosperous country but the country also faces major social and economic challenges. Since the financial crisis banks, companies, households and the government are working on running down their debts. At the same time there are large financing issues, for example with respect to the investment we have to make in infrastructure, energy supply, healthcare and improving the education system.

Businesses have a need for financing. And our very internationally-oriented businesses require banks with global networks and sufficient scale to provide specialised services efficiently and on reasonably favourable terms. Banks also play a significant role in responsible financing of the housing market. Against the background of these complex challenges, it is vital that the public can continue to count on a stable, service-oriented and reliable banking industry which offers products and services in line with the often widely divergent wishes of consumers, businesses, institutions and governments. This attaches requirements to the competencies of banks to realise promises and expectations. It is necessary to create market conditions that ensure healthy competition based on a varied banking landscape and provide a sufficiently diversified offer, for example, in terms of the type of activities and services, structure and geographical range.

We are, therefore, working on the following assumptions in our shared struggle for a stable, service-oriented and reliable banking industry:

The banking industry is pluriform and offers customers a wide choice

Each Dutch bank has its own mission, strategy and targets. Banks are also different in size, activities, structure and geographical range. Diversity within the banking industry is important for ensuring that customers have the best possible range of choices. The public must be able to rely on customers having sufficient freedom of choice and the availability of specialised services for customers who need them.

In addition to a diverse banking sector, a diverse workforce in the sector contributes to the quality of the service provision.
Banks are reliable, service-oriented and transparent
Bank customers and society in general must be able to count on reliable, service-oriented and transparent banks. Banks ensure the continuity and reliability of their services and focus in their operations on the interests of customers and other stakeholders. Banks are transparent about the products and services they offer and about the costs and risks involved. Products and services are geared to the needs and profile of the client. Furthermore, it will be transparent how the interests of the client are centred on. A bank’s risk policy is characterised by an integral approach, it is transparent and aimed at both the short and long term.

Bank employees are ethical, expert and professional and ensure that customers and other stakeholders are treated with care
Banks offer an important service to consumers, businesses and the public sector and so integrity, expertise and professionalism are absolute requirements for everyone who works for a bank. In performing their work, all bank employees are expected to draw a careful balance between the interests of customers, society, the bank itself and its employees, providers of capital and the bank’s other stakeholders. This applies especially to their duty of care and service to customers. This has to be expressed in banks’ culture, governance and operations and in relation to the customer. Investment banking and proprietary trading activities are, therefore, always related to the service to customers or careful management of risks and are not an object in themselves.

Banks have a social responsibility to contribute to a sustainable economy
The role of banks is expressed in part in their contribution to society. A healthy and sustainable economic development requires a well-functioning financial sector and vice versa. After all, banks can play a significant role in anticipating developments such as the sustainability of energy supplies and the long-term viability and quality of healthcare. Furthermore, a socially responsible approach means that, jointly and individually, banks should contribute to education and information to enhance the general level of public knowledge of money matters in order to support customers in making their own responsible financial decisions. As a result of its own mission and core values, every Dutch bank has a policy in the fields of corporate sustainability and corporate social responsibility. The sustainability policy of banks follows (international) guidelines and legislation.

2 Banking Code
Our Social Charter explains how the banking industry sees its role and position in Dutch society and guides our positioning, the structure of our organisations, the formulation of internal regulations, rules of conduct and other codes and the performance of our work. As such, therefore, the social charter is complementary to the Banking Code. The Banking Code was introduced in 2010 so that banks would commit to and account for treating their customers with care while balancing the interests of the various stakeholders. The Code has played a significant role since its introduction and many of its principles on the supervisory board, executive board, risk management, audit and remuneration policy have since been incorporated into legislation. The introduction of this Code has contributed to banks having strengthened their governance and risk management and specifically making the interests of their customers more central. The update of the Banking Code takes into account the recommendations of the Banking Code Monitoring Commission,1 the report of the Committee on the Structure of Dutch Banks,2 the government’s views on the Dutch banking industry3 and A new balance: Towards a service-oriented, stable and competitive banking sector – the Vision of the
Dutch Banking Association. The principles in the ‘old’ Code which have now been incorporated in legislation and regulation are not repeated in the new Banking Code. Needless to say banks will continue to obey these national and international rules. The Banking Code applies to all activities performed in or directed towards the Netherlands by banks established in the Netherlands and licensed by the Nederlandsche Bank pursuant to Section 2:11 of the Financial Supervision Act. In the event of overlap or contradiction with international legislation or the policy of regulators, this prevails over self-regulation such as the Banking Code.

The new Banking Code is designed – along with the Social Charter and the introduction of the bankers’ oath, rules of conduct and disciplinary scheme discussed below – to make a major contribution to public trust in banks and their role in the community. Consequently, the principles in the updated Code emphasise the importance of sound and ethical operation by banks and set this out in the principles for the executive board and supervisory board, proper risk management, thorough audit processes and a sound, balanced and sustainable remuneration policy.

**Sound and ethical operation**

To build and maintain its position as a stable and reliable partner, a bank must formulate its mission, strategy and objectives. These focus on the long term and are expressed in part in the bank’s risk policy and the policy for sustainability and corporate social responsibility.

A bank chooses its positioning such that its commercial interests and social role are extensions of each other. This is also expressed in the bank’s governance structure and guides the implementation of its policy based on its mission, strategy and objectives. The executive board and supervisory board are – with due regard for each other’s duties and powers – responsible for setting up a sound governance structure and compliance with the governance principles. The members of these boards will set an example to all of the bank’s employees and exhibit this in their day-to-day activities. The supervisory board will evaluate the way the members of the executive board are setting an example each year.

The executive board and supervisory board are – with due regard for each other’s duties and powers – responsible for developing, communicating and enforcing standards on integrity, morals and leadership in the bank. In addition, they ensure there are proper checks and balances and they safeguard a solid IT infrastructure that is vital for the functioning of the bank. Among other things, thorough checks and balances mean that the compliance function is also safeguarded within the executive board and supervisory board.

The executive board will promote responsible behaviour and a healthy culture both at the top of the bank and throughout its organisation. In this, it will consider the interests of the bank’s customers and other stakeholders. The supervisory board supervises this.

A bank’s culture must also express the assumptions in the Social Charter of the Dutch Banking Association. These must be embedded in the bank’s organisation and the bank
will include them in its contact with its stakeholders. It will provide an insight into the way in which the bank deals with the assumptions in the Charter. All employees will comply with the formal regulations and self-regulation that apply to them. The executive board and supervisory board are—with due regard for each other’s duties and powers—responsible for this. The executive board is responsible for employees being and remaining familiar with all rules, values and standards applicable to the bank and will continue to pay attention to this. The supervisory board supervises this.

**Supervisory board**
The supervisory board will be composed in such a way that it is able to perform its tasks properly. It will form a risk committee and an audit committee. The members of the supervisory board will be prepared and able to make sufficient time available for their duties and exhibit effort and commitment. They will at the same time be critical and independent.

Each member of the supervisory board will be aware of the social role of a bank and of the interests of the various stakeholders. There are specific competence and experience requirements for members of the supervisory board’s risk and audit committees. Members of the risk committee must have thorough knowledge of the financial aspects of risk management or the necessary experience to permit a thorough assessment of risks. Members of the audit committee must have thorough knowledge of financial reporting, internal control and audit or the necessary experience to permit thorough supervision of these subjects.

The chairman of the supervisory board will organise a programme of lifelong learning for all members of the supervisory board with the aim of maintaining their expertise at the required level and improving it where necessary. The learning programme will in any event cover relevant developments at the bank and in the financial sector, corporate governance in general and in the financial sector in particular, the duty of care towards customers, integrity, IT infrastructure, risk management, financial reporting and audit.

Every member of the supervisory board will take part in the programme and meet the requirements for lifelong learning. The assessment of the effectiveness of the programme of lifelong learning will be part of the annual evaluation performed by the supervisory board.

In addition to the supervisory board’s annual self-evaluation, the functioning of the supervisory board will be evaluated under independent supervision once every three years. The involvement of each member of the supervisory board, the culture within the supervisory board and the relationship between the supervisory board and the executive board will be part of this evaluation.

Each member of the supervisory board will receive appropriate compensation for the amount of time that he or she spends on supervisory board activities. This compensation will not depend on the bank’s results.

**Executive board**
The executive board will be composed in such a way that it is able to perform its tasks properly. Each member of the executive board will be aware of the social role of a bank and of the interests of the various stakeholders.

One member of the executive board will have the duty of preparing decision-making by the executive board on risk management. This member will be involved in good time in the preparation of decisions that are of material significance for the bank’s risk profile, especially where these decisions may result in a departure from the risk appetite approved by the supervisory board. This member may combine his or her function with other responsibilities, provided that he or she does not bear any individual commercial responsibility and operates independently from commercial areas.
Risk management will also include a focus on the impact that systemic risk could have on the bank’s risk profile. The chairman of the executive board will organise a programme of lifelong learning for all members of the executive board with the aim of maintaining their expertise at the required level and improving it where necessary. The learning programme will in any event cover relevant developments at the bank and in the financial sector, corporate governance in general and in the financial sector in particular, the duty of care towards customers, integrity, risk management, financial reporting and audit. Every member of the executive board will take part in the programme and meet the requirements for lifelong learning.

**Risk policy**
A bank’s risk policy is characterized by a comprehensive approach, is transparent and has both a short- and long-term focus. The risk policy also takes reputational risks and non-financial risks into account.
A bank’s executive board will be responsible for its risk policy and ensure proper risk management. The executive board will propose the risk appetite to the supervisory board for approval at least once a year. Any material changes to the risk appetite in the interim will also require the supervisory board’s approval.
The supervisory board will supervise the risk policy pursued by the executive board. As part of its supervision, the supervisory board will discuss the bank’s risk profile and assess at a strategic level whether capital allocation and liquidity requirements are generally in line with the approved risk appetite and whether operations in general are in line with the bank’s risk appetite. In the performance of this supervisory role, the supervisory board will be advised by its risk committee.

**Audit**
A bank’s executive board will ensure that a systematic audit is conducted of the management of the risks related to the bank’s operations. To this end, a bank will have its own internal audit department with an independent position within the bank. The head of the internal audit department will report to the chairman of the executive board and also have a direct reporting line to the chairman of the supervisory board’s audit committee.
The internal audit department, external auditor and supervisory board’s audit committee will consult periodically.
The internal audit department will take the initiative in arranging talks with DNB (the Dutch central bank) and the external auditor at least once a year to discuss each other’s risk analyses, findings and audit plans at an early stage. The bank’s executive board and internal audit department will encourage these tripartite talks, aiming for a clear delineation of each other’s duties and responsibilities.

**Remuneration policy**
The bank will implement a detailed, restrained and long-term remuneration policy that is unambiguous and transparent and in line with national and international regulations.
The remuneration policy will have a primarily long-term focus and be in line with the bank’s risk policy. It will incorporate an internal and external balance of interests, taking into account the expectations of the various stakeholders and social acceptance. It will also take the relevant international context into account.
The total income of a member of a bank’s executive board will at the time it is set be below the median for comparable positions inside and outside the financial industry, taking into account the relevant international context.
The variable remuneration of a member of the executive board will be set in accordance with national and international regulations.
3 Accountability and monitoring of the 2014 Banking Code

The Banking Code comes into effect on January 1st 2015 and applies to all banks with a registered office in the Netherlands. Banks which are members of a group and subject to the Banking Code may apply parts of it at the level of the entity heading the group.5

The Banking Code does not stand alone but is part of the full set of national and international regulations, case law and self-regulation. When applying its principles, a bank will take this national and international context, the social environment it operates in and other specific characteristics of the individual bank and group, if it is part of one, into account. Furthermore, the Banking Code will also be applied with due regard to balanced consideration of the interests of the various stakeholders. The principles may only be partially applied if differences so justify.

Transparency

Each year, every bank will report on its website on how it applied the Banking Code in the previous year, explaining progress made in applying the principles and offering specific examples of compliance. If necessary the bank will provide a substantiated explanation of why a particular principle may not have been applied, either partly or in full (‘comply or explain’).

A decisive factor in the proper functioning of the Banking Code is not the extent to which there is compliance with the letter of the Code (box ticking’), but the way in which the spirit behind its values and principles is observed in practice.

Monitoring

Compliance with the Banking Code will be monitored annually by an independent monitoring committee appointed by the Dutch Banking Association.

The monitoring committee will report its findings at least once a year to the Dutch Banking Association. These findings will be published.

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5 In that case, the banks forming part of that group do not have to apply those parts on an individual basis.

Banks subject to Section 3:111 of the Financial Supervision Act need not apply the Banking Code individually.

4 Oath and discipline

Along with the introduction of a Social Charter and updating the Banking Code, the Dutch banking industry has also taken the initiative to implement the bankers’ oath for all employees. The Dutch banks intend this to show that everyone working in the industry is bound by the rules of conduct attaching to this statement for the ethical and careful practice of his/her profession. Employees have personal responsibility for complying with those rules of conduct and can be held accountable for non-compliance.

Since early 2013, policymakers and supervisors of financial institutions have by law had to sign the bankers’ oath. The initiative to have all bank employees take the oath will be a significant tool in creating the new culture wanted in the banking industry. A disciplinary scheme will be introduced to ensure that taking the oath is not without meaning. Bank employees will, therefore, be accountable to society as a whole.

5 Rules of Conduct
Who do these rules of conduct apply to?
These rules of conduct apply to you if you work in the Netherlands for a bank with a Dutch banking license that is a member of the Dutch Banking Association (NVB), or if you work for a bank that wishes to apply these rules of conduct. These rules of conduct apply to:
* the bank’s management,
* the bank’s supervisors / internal regulators,
* the bank’s staff who have a contract of employment, and
* all other individuals performing work for the bank that is directly related to the banking activities.

What rules of conduct apply to you?
The rules of conduct that apply to you in your work for the bank are listed below. Because not everyone performs the same work for the bank, more may be expected of one person than of another.
Each rule of conduct is followed by a brief explanatory note.

1 You work with care and integrity
This means, among other things, that you
- are honest and trustworthy in your work,
- avoid conflicts between your own interests and those of others, and
- avoid any semblance of a conflict of interests.

2 You weigh interests carefully
This means that in your work you seek a careful balance between the interests of the bank’s customers, the shareholders, the members, the bondholders and the bank’s other creditors, the bank’s employees and society.

3 You put the customer’s interests first
When weighing these interests you put the customer’s interests first. This means, among other things, that you
- inform the customer as fully as possible about the products and services and the associated risks,
- do not offer customers products or services that do not suit them,
- seek to ensure that a product does not expose a customer to irresponsible risks, and
- seek to ensure that a product and the attached conditions are understandable to the customer.

4 You comply with the law and other rules that apply to your work for the bank.
This means, among other things, that in your work you comply with the law, regulations, rules of conduct and instructions that apply to your work for the bank.

5 You keep confidential information secret
This means, among other things, that you do not disclose confidential information about customers to third parties without their permission. You only disclose information about customers to others if you are required to do so under the law, a court order or the regulator. Neither do you misuse information available to you.

6 You are transparent and honest about your conduct and are aware of your responsibilities to society
This means that you have your work assessed with reference to these rules of conduct.

7 You contribute to society’s confidence in the bank
This means, among other things, that in your work you take no risks that endanger either the bank or others.

What do these rules of conduct mean for you?
1. You abide by these rules of conduct. To this end you swear an oath or make a statement. You only have to do this once. Disciplinary rules also apply to you.
2. Did you work for the bank before 1-1-2015? In this case, you swear an oath or make a statement to one of the bank’s managers before 31-12-2015. The rules of conduct and the disciplinary rules will apply to you as of the moment you swear the oath or make the statement.
3. Are you going to start working for the bank as of 1-1-2015? In this case, the rules of conduct and the disciplinary rules apply to you immediately. You should swear an oath or make a statement to one of the bank’s managers within three months.
4. You use the form below for swearing the oath or making the statement. This is stated in the financial Supervision Act (Wet op het financieel toezicht). You use the declaration below to sign the disciplinary rules.

**What happens if you don’t abide by the rules of conduct?**

Have you breached the rules of conduct? Then you will face disciplinary action.

1. This means that individuals or organisations can file a complaint against you. In this case, the <name and disciplinary committee> can investigate your conduct. How this investigation is conducted by <name and disciplinary committee> is set out in the disciplinary regulations.

2. The disciplinary regulations also explain what happens if you have breached the rules of conduct. For example what penalty will be imposed on you. The regulations also explain what you can do if you disagree with <name and disciplinary committee>. In this case you can appeal.

When do these rules of conduct enter into force?
The NVB adopted these rules of conduct on <date>. When the rules of conduct and disciplinary rules become applicable to you is indicated above. Please note! The rules of conduct and disciplinary rules do not apply to your earlier conduct.

**Addenda**

The rules of conduct have been drawn up by the members of the Dutch Banking Association (Nederlandse Vereniging van Banken, NVB). The members adopted the rules of conduct in the General Meeting of members of the NVB on <date>.

The members of the NVB seek to achieve the following with the rules of conduct:
- to establish the desired conduct of everyone working for a bank,
- to make society aware of the rules of conduct that bank employees have to abide by,
- to increase society’s confidence in banks.

The members of the NVB require everyone to abide by the rules of conduct.
- This is why all bank employees swear an oath or make a statement. This way, they swear or promise to abide by the rules of conduct.
- If a bank employee breaches the rules of conduct, he or she will face disciplinary action associated with the rules of conduct. What happens in this case is set out in the disciplinary regulations. For example, what penalty can be imposed on the employee.

**Form disciplinary scheme**

[name of relevant party] hereby declares to observe the rules of conduct, to subject himself to enforcement of the rules of conduct and to acknowledge the exercise of powers by [DSI] and the Disciplinary Committee which they hold by virtue of the banking sector Disciplinary Scheme;

Relevant party [signature of relevant party]
**Bankers’ Oath**

*Form for the oath/affirmation by an employee other than a director or member of a body charged with supervision of policy and the general affairs of the business.*

I swear/promise within the limits of my role that I perform at any moment in the banking sector:
- that I will perform my duties with integrity and care;
- that I will carefully consider all the interests involved in company, i.e. those of the clients, the shareholders, the employees and the society in which the company operates;
- that in this consideration, I will give paramount importance to the client’s interests;
- that I will comply with the laws, regulations and codes of conduct applicable to me;
- that I will observe confidentiality in respect of matters entrusted to me;
- that I will not abuse my knowledge;
- that I will act in an open and assessable manner and I know my responsibility towards society;
- that I will endeavour to maintain and promote confidence in the financial sector.

So help me God/This I declare and promise.

The oath/affirmation was taken/made in the above form on [date], at [place], before [name of person who administered the oath] in the presence of [name of other representative of the business or industry or professional organisation].

Furthermore, [name of the person] confirmed his/her acceptance of the enforcement of the rules of conduct by the Disciplinary Committee and the exercise of authority by the Director General pursuant to the disciplinary scheme in the banking industry rules of conduct.

Name [signature]

* The final text will be brought into line with the text of the Dutch Financial Supervision
Dames en heren,


Goed nieuws dus. Maar tegelijkertijd wil ik niet te snel tevreden zijn. We zijn er nog lang niet. De cijfers zijn weliswaar een voldoende waard, maar voldoende is in dit geval niet goed genoeg. Want er is nog iets. En dat heeft de ECB niet onderzocht. Heeft u genoeg aandacht voor het maatschappelijk vertrouwen in uw banken? Het antwoord hierop moet helaas negatief zijn. Staat de klant wel echt centraal? Daar kom ik zo uitgebreid op terug, maar laten we eerst naar de cijfers kijken.

We hebben harde eisen en criteria gesteld aan de banken. Maar nog steeds zijn de banken niet stabiel genoeg. Dat geldt in Nederland, maar dat geldt nog meer in Europa. Want het assessment laat zien dat banken in veel landen de komende jaren nog veel stappen moeten zetten om zelfstandig de kapitaalratio’s te versterken tot de vereiste niveaus. Uit het onderzoek komt ook naar voren dat de regels over de kwaliteit van het kapitaal in de verschillende landen nog niet op elkaar aansluiten. Dat maakt vergelijken lastig. En daardoor wordt duidelijk dat het onderzoek slechts een momentopname biedt, en dat meer nodig is om volledig gezond te worden. Voor de duidelijkheid, banken moeten dit zelf doen, zonder publieke steun. Laat ik drie voorbeelden geven van wat er in mijn visie nog moet gebeuren.

Ten tweede hebben overheden in sommige landen de kapitaalpositie van banken de afgelopen jaren versterkt. Niet zoals u misschien denkt door het redden van banken die omvielen. Maar dit deden ze door een deel van het kernkapitaal te garanderen, via zogenaamde belastingkredieten, of Guaranteed Tax Assets. Dit is volgens de regels toegestaan, maar het is niet in lijn met de gedachte van de bankenunie. En wat mij betreft ongewenst. We moeten de houdgreep tussen banken en overheden juist doorbreken. Ook op dit punt moeten de regels dus veranderen.

Ten derde en meer specifiek gerelateerd aan Nederland, blijkt dat de gemiddelde buffers van Nederlandse banken laag zijn ten opzichte van andere landen. Het gaat hier specifiek om de leverage ratio. Alleen België scoort lager. Dat moet dus beter. Ik weet dat we dit cijfer kunnen nuanceren. De hypotheken, die in Nederland een relatief groot deel van de totale bankbalans uitmaken, drukken de hoogte van deze buffer. Daarnaast ligt de slechte score voor een deel aan de gebruikte definitie. Als we de strengere definitie gebruiken die geldt wanneer CRD-IV volledig is ingefaseerd, dan scoren de Nederlandse banken waarschijnlijk al wat hoger, maar niet hoog genoeg. Maar ik word ook niet zo enthousiast over gemiddeld. Daarom zetten we verdere stappen. Zo dienen de vier grootste banken ervoor te zorgen dat hun leverage ratio uiterlijk in 2018 minimaal 4% bedraagt, in lijn met de kabinetsvisie over de toekomst van de bancaire sector. Deze discussie is volop bezig in internationaal verband. En ik weet niet of in 2018 4% het relevante percentage zal zijn.

Ik zie het aan het begin al: u bent geslaagd voor het toelatingsexamen van de bankunie. U heeft voldoendes gehaald voor de telbare criteria, op basis van de huidige eisen. Maar er is ook nog een andere kant. Met criteria die we niet in de berekeningen van de ECB zien. Heeft u voldoende oog voor wat de samenleving nodig heeft? Doet u genoeg aan het herstellen van vertrouwen? Ik zie dat u ermee bezig bent. Ik zie en waardeer ook de inspanningen van de NVB op dit terrein. Maar het is nog niet genoeg.


Dames en heren,

Er zijn genoeg bankiers die heel goed begrijpen dat we niet alleen de harde, maar ook de zachte criteria moeten verbeteren. Bankiers die weten dat we er nog niet zijn. Ik begon mijn verhaal met een waarschuwing voor zelfgenoegzaamheid. Maar ik was natuurlijk ook tevreden met de resultaten van de Nederlandse banken. En er zijn zeker redenen voor optimisme. Het toezicht, waar zeker ook fouten zijn gemaakt, is verbeterd. De regelgeving, die niet voldeed, is verbeterd. De ruimte, die onverantwoordelijk gedrag mogelijk maakte, is verkleind.
De NVB grijpt haar 25-jarig jubileum aan om te bezien hoe het beter kan. Vandaag stuur ik een brief naar de Tweede Kamer waarin het kabinet reageert op de voorstellen van de NVB voor de toekomst van bankieren. Ik zie wat er al gebeurt.

De NVB doet voorstellen op drie niveaus. Met een Maatschappelijk Statuut, een nieuwe Code Banken en gedragsregels. In het Maatschappelijk Statuut staan de uitgangspunten die banken gebruiken bij het streven naar een stabielere, dienstbare en betrouwbare bancaire sector. De NVB doet op ondernemingsniveau met de vernieuwde Code Banken voorstellen voor een bankensector die nadrukkelijk rekening houdt met de zachte normen. Daarmee wordt gewerkt aan een sector die meer transparantie biedt, doordat banken in hun jaarverslag en op hun website verantwoording moeten afleggen over deze code. Een sector die meer oog heeft voor de maatschappelijke verantwoordelijkheid en de deskundigheid van de medewerkers; ook de kennis en ervaring van de raad van commissarissen. Een sector die een beloningsbeleid hanteert dat op de lange termijn is gericht. Ten slotte kan door de gedragsregels ook een individu op zijn gedrag worden aangesproken.


Dank u.
Banks play a central role in the functioning of the economy. Not only do they allocate financial resources, they also collectively create money in the process of granting loans. In this way, they have a considerable impact on the type of activities that are financed in society. During the financial crisis, it became clear that the banking sector at large was not sufficiently stable and customer-focused. Since then, banks and regulators alike have been busy reviewing bank business models, and several committees have been installed to investigate the desired scale and scope of banking activities. This is the backdrop against which the conference on “The Value of Banks and Their Business Models to Society” was organized jointly on October 4, 2013 by De Nederlandsche Bank (DNB), Rabobank and SUERF and hosted by the Duisenberg School of Finance. This volume contains several of the presentations at the conference.

The conference started off with the 2013 SUERF Annual Lecture by Lex Hoogduin. In a thought-provoking speech, which is included as chapter 2 in this volume, he emphasized the importance of human psychology, and of economics as a moral science. Crises cannot be avoided, as the three root causes of crises are uncertainty, human creativity and evolutionary determined human psychology. These insights call for modesty in the ambition of what can be achieved to reduce instability without hampering progress. Hoogduin warned that trying to engineer culture and morals too much can easily be counter-productive and even lead to disaster. Turning to banks, Hoogduin discussed the core functions of banks and how these add value. He also presented his views on current policy measures and proposals.

Teunis Brosens (ING) presented a paper written jointly with Wilfred Nagel (ING) entitled “The Good, the Bad and the Big: Is There Still a Place for Big Banks?” The authors argue in chapter 3 that answering the question “When is big too big?” is not easy. Size generates gains in efficiency, profitability and diversification, but as banks grow bigger and bigger, “too big to manage” may become an issue. Many banks have recognised this and are simplifying their structures and pruning product ranges and balance sheets. All of this is primarily a concern for the bank’s owners. The one reason for policymakers to care and intervene is “too big to fail” and the ensuing taxpayer risk. However, banks and regulators are currently implementing far-reaching changes that substantially reduce the chance that taxpayers ever have to step in again. They therefore advise policymakers to avoid overshooting. Policy should not overreact by striving to eliminate or split each and every big bank. Instead, the authors think that both financial stability and the economy are best served by a diverse banking landscape inhabited by different types of banks.

Harry Huizinga (Tilburg University) presented a paper written jointly with Ata Can Bertay (Tilburg University) and Asli Demirgüç-Kunt (World Bank) entitled: “Size and Stability of Big Banks” (chapter 4). The study investigates the relationship between size and probability of default. The authors distinguish between absolute bank size (measured by the log of total assets) and systemic bank size (ratio of total liabilities to GDP). The correlation between absolute and systemic size is only 0.327, so it is important to distinguish between these. The analysis is based on a large international sample of
exchange-listed banks over the years 1991-2011. Most banks (86%) are rather small in relation to GDP, but there is a tail of 9% of large banks, with liabilities exceeding 100% of GDP. Looking at the data, the authors find that absolute and systemic sizes have a distinct impact on various variables, such as interest expense, returns, strategy and funding structure. For instance, banks with a large absolute size have a relatively lower capitalization, higher fee income share, and higher non-deposit short-term funding share. Banks with a large systemic size also have lower capitalization, but they have a lower fee income share and a lower non-deposit short-term funding share. Systemically large banks also saw significantly lower deposit growth during the crisis. Large banks, in both absolute and relative terms, tend to pay lower interest rates. This suggests that large banks are considered to be too-big-to-fail with implied risks from the government’s perspective.

The keynote address was given by Aerdt Houben (Director Financial Stability Division DNB). The title of the address was: “Have We Solved the Too-Big-To-Fail Problem?” It is included as chapter 5 in this volume. Cutting directly to the chase, Houben said that the short answer is: “Almost!” And then added that we’ll never fully solve it.

Houben discussed three ways of reducing the too-big-to-fail problem.

First of all, we should reduce the probability that problems arise. This is mainly done by improving capital and liquidity positions, as set out under Basel III and implemented in CRD/CRR IV. All in all, from 2017 onwards, core tier 1 capital (including the additional buffer for systemically important banks) will be 4-5 times higher than the 2% required under Basel II.

Second, when problems arise, we should reduce the bill to pay. This can be achieved through resolution plans. If economically critical activities can be separated from the other activities of banks, this will reduce the span of the public safety net and, by implication, the bill to be paid by taxpayers if trouble arrives. Houben stressed that this is a difficult process: when cutting out non-critical parts of a bank, these activities may not be viable on their own.

Third, losses should be shifted from taxpayers to bank creditors: bail-in instead of bail-out. In the Netherlands, the Intervention Act allows the Minister of Finance to expropriate shareholders and certain other groups of financiers. This was done in the case of the nationalization of SNS-Reaal, which entailed a 100% write-off of shareholders and a full bail-in of subordinated debt. Another recent bail-in example was that of Cyprus. Further afield, in Europe, work is going on in the context of the Bank Recovery and Resolution Directive (BRRD), towards introducing ‘bail-in debt’. From 2016 onwards, this instrument will allow for the losses from a failed bank to be borne by the bank’s creditors without state support. Such ‘bail-in debt’ may, when difficulties mount, be converted into share capital or written off outright. Under the current draft BRRD, a new loss hierarchy will be introduced.

First, losses up to 8% of total assets are to be absorbed by shareholders and holders of other instruments. Then, losses up to 5% of total assets may be borne by the European Resolution Fund for banking union countries. After that, the ESM (European public backstop) or national backstops may provide support, which means that the taxpayer would only be hit after 13% of the balance sheet is bailed-in. Looking back at European bank losses in the years 2007-2012, the losses averaged some 3% of the balance sheet. Only the losses of Anglo Irish Bank exceeded the 13% threshold. So while the need for state support cannot be precluded even after implementation of the BRRD, the probability will be strongly reduced.

Both the expropriation instrument and the bail-in debt may be used if the supervisory authority considers the institution no longer viable. This discretionary power in the hands of the supervisor creates uncertainty for senior unsecured investors. In order to reduce that uncertainty, some institutions have issued contingent convertible bonds (Coco bonds). These can be converted into equity capital or be written off entirely if the capital position of a bank falls below a predetermined level. Thus whereas Coco bonds have the same effect as expropriation and bail-in debt, they reduce the uncertainty for the other senior unsecured financiers.
The contributions to the panel discussion, chaired by Dirk Schoenmaker (Duisenberg School of Finance), have been included in chapter 6. Schoenmaker argued that the business models of international banks are very different. The two polar cases are the globally integrated banks operating through a worldwide web of branches, and the decentralised global banks with various country subsidiaries.

The difference between the two business models is clearly relevant. But by using a common brand name, decentralised banks are regarded as integrated groups by market investors. Moreover, decentralised banks also perform some key functions, such as the development of their risk management model, at the central level. Schoenmaker therefore stresses the need for international coordination between national supervisors to ensure effective supervision at the consolidated level. Such a consolidated supervisory approach may keep the international business model of banks alive. The alternative approach of national based supervision will de facto mean the end of the international banking model.

Harald Benink (Tilburg University) insisted on the need for a credible backstop, which among other things requires that intervention and resolution laws are in place. He suggested already introducing bail-in in the upcoming Asset Quality Review (AQR). This is especially important if the amount of hidden losses still out there in the European banking system turns out to be high. Benink would not be surprised if losses yet to be uncovered would exceed EUR 500 billion. If capital shortage cannot be financed in financial markets or by taxpayers, then a bail-in is needed. A legal framework is needed, such as the Intervention Act in the Netherlands. Benink believes that the ECB should demand that countries should have a legal mandate before the AQR is finished. Without these contracts, the ECB should refuse to take these banks under its supervision. Unfortunately, the ECB seems somewhat divided on the question of whether private or public money should be available as a backstop.

Andreas Bley (BVR Association of German Cooperative Banks) stressed the need for diversity of bank business models. The cooperative model in general and the German cooperative model in particular deserve special attention. In Germany, cooperative banks serve 20-25% of the market, and they weathered the financial crisis without state aid. The cooperative bank system in Germany consists of about 1,100 entities that are legally independent from each other, but work together as a network. For example, they have central banks and specialized institutions to provide services an independent bank cannot provide. The median size of cooperative banks is about EUR 300 million in total assets. According to Bley, a credit crunch in the aftermath of the financial crisis has been averted in Germany due to the presence of the cooperative banks. Finally, he warned that regulation may not always be adequate for cooperative banks. For instance, how can cooperatives meet the required level of bail-inable assets by issuing debt instruments such as Coco’s if these small banks never went to the capital market before?

Alicia Sanchis (Banco Santander) stressed the need for banks to refocus on clients and their needs, on risk management, on understandable contracts, and on their relationship with markets. In terms of risk management, project viability must be put center stage avoiding an overreliance on collateral. The transformation functions remain at the core of banks, but given pressure on the banking sector and the funding mix, banks should not stretch the maturity transformation too much. Markets and other forms of (co-)financing could be developed more, and the role of banks becomes that of an intermediary providing expertise. Regulation should allow banks to pursue this re-focusing; legal uncertainty stemming from new rules and regulations should be reduced, and a level playing field with institutions not falling under the same degree of supervision should be put center stage.

Michiel Bijlsma (CPB) discussed how banks are organized, and the long-term drivers affecting bank scope and scale. Though much in vogue right now, regulation is not the key driver. Technology
more important. Technology will reduce transaction costs, information asymmetries and economies of scope, while it will increase economies of scale. As a result, banks will become even bigger. They will also become more specialized and the role of international financial markets in the financial system will become more important. Therefore the key issues for policy are: How to cope with ever bigger banks? How to deal with the national and international presence of banks? How to deal with free riding on information collection in international financial markets? What tasks should be organized nationally/internationally, for example payment systems? Bijlsma stressed the information problem that was at the heart of the financial crisis. People were buying complex products, believing that others had checked them out. There is an underproduction of information on risk, because for trading purposes it is easier and cheaper to use information gathered by others.
THE VALUE OF BANKS AFTER THE GREAT FINANCIAL EXPANSION
Lex Hoogduin

2.1. INTRODUCTION

It is a great honour to give the 2013 SUERF Annual Lecture in SUERF’s 50th anniversary year at the Duisenberg School of Finance in Amsterdam.

Today we still live in the aftermath of the greatest financial crisis since World War II. It has shaken confidence in the banks, bankers and the financial sector at large. Many observers argue that banks have been value deductors rather than value creators. They have become too-big-to-fail, too-big-to-save, or too-complex-to-manage. Several new regulations have been enacted in the meantime. But there is still a lot of anger towards banks. There is a moral dimension in much of the criticisms. Banks and bankers have taken irresponsible risks. They have strongly benefited in the upswing and left the taxpayers with the bill after the crisis, is the view. This has triggered calls for more fundamental change in the financial sector. Bankers have lost sight of their clients, focus too much on short-term gains and too little on what is in the long-term interest of society. Changing this requires a change in culture inside the banking sector and also a change in many banks’ business models. Clients should take central stage far more than was the case in the past decades.

Today’s conference focuses on the issues of the value of the banking sector to society and business models in the banking sector. I will also focus this annual lecture on those issues. I will prepare the ground by briefly discussing economics as a moral science, the root causes of financial crises, the role of banks in society and the decades’ long process in the run-up to the financial crisis of 2007 which I call the period of the Great Financial Expansion (GFE). This is the context in which I will discuss the value of banks to society and their business models.

2.2. ECONOMICS AS A MORAL SCIENCE

I am an economist. It requires some explanation why an economist should speak about an issue also taking a moral perspective. It is largely forgotten that economics used to be a moral science. And in my view it still is and ought to be the case to make sense.

When I speak about the value of banks, I have indeed in mind more than just value in terms of monetary added value.

As said, I believe that the debate about banks is not just about added value expressed in money. It is also not without reason that the expression moral hazard, with the emphasis on ‘moral’, plays an important role in discussing behaviour in the financial sector.

What is the topic of economics? It deals with decision-making about scarce resources in the face of uncertainty. It is about individual choice and intended as well as unintended consequences of such choices at the macro level.

In modern mainstream economics the decision maker is modelled as an agent who maximizes utility or profit. This has, in practice, turned economics into a rather technical, morally neutral science. Economics in this approach is only about efficiency. But it thereby misses the point that people cannot and do not take their decisions in isolation. They are moral beings and in their decisions, views about what ought and ought not to be done, about what is morally good or bad play a central role. That gives a different perspective on many issues. To give one example: In mainstream economics the question “what is the optimal level of inflation?” is a normal question. In a morally grounded approach inflation may be seen as bad, not as something to be optimised but to be avoided. Economics as a moral science does not start from an ‘empty’ utility function, but has to know the values in a certain group or society, how they influence choices, and therefore what their impact is. Since moral values are not static, knowledge about history is required. Economics as a
moral science needs to be linked to ethics, psychology, political science, and sociology and needs a framework for analysing the evolution of moral values.

My own perspective on the evolution of moral values in society has been strongly influenced by Hayek and Popper. There are strong limits to human’s capacity to rationally design an ethical system2. Hayek (1978a) calls the false idea that we can, “the error of constructivism”. Ethical systems evolve over time in a spontaneous process. The prevailing ethical system embodies far more knowledge than anybody can possess. Decentralised decision-making in a market economy is superior to central planning, not only in efficiency terms, but also in moral terms. It allows for freedom, that is the opportunity for people to pursue their own goals with their own knowledge (Hayek, 1945). The mirror side of freedom is that man is responsible and accountable for his choices. That does not mean that we need no government, but that government should only step in, where decentralised decision-making cannot work properly and to provide the framework for decentralised decision-making.

2.3. FINANCIAL CYCLES AND CRISES

The market system is imperfect. One of its imperfections is that it is prone to cyclical fluctuations and periodic crisis. Although all financial cycles and crises have their own characteristics and are different, they follow a similar pattern and have the same root causes3. In that sense what Mark Twain is often quoted as having said about history also applies to financial cycles and crises: “History does not repeat itself, but it does rhyme”.

I see three root causes of financial crises in market economies: fundamental uncertainty, human creativity and evolutionary determined human psychology. Human creativity offers new opportunities as time moves on. But we cannot know when that will happen, how big the opportunities are and what their contents is. If we would already know now what future opportunities are, they would not be new. Logically, man cannot know in advance the development of his own knowledge. That is part of the human condition, like scarcity.

Uncertainty also means that the price of assets cannot be objectively known. Prices are by definition subjective. That in combination with human traits, such as greed, desire to act, and herd behaviour, can lead to booming asset markets and asset price increases up to a point where they turn out to be unsustainable. And then the whole process goes into reverse. Abruptly.

Especially at the end of the boom, there are often cases of immoral behaviour. But this is not so throughout the boom phase. Nor is immoral behaviour at the root of cyclicity. There are also human traits that check the development of exuberance like fear, worries and panic, but they are not always strong enough and may only get the upper hand when it is too late.

This may be the result of evolutionary dynamics. The same traits that cause cyclicity are at the root of entrepreneurship resulting in innovation and productivity growth. They are thereby the sources of economic growth, progress, and increasing welfare. They have helped mankind to survive and solve problems.

3 See Reinhart and Rogoff (2009), Kindleberger and Aliber (2011) and Minsky (1986).

Cyclicity and crises are the inevitable by-product of economic and human progress. This may also explain that, so far, no ethical system seems to have emerged that acts as a strong break on
cyclicality and crises. The opposite may rather be the case. Our moral system may well be pro-cylical around otherwise relatively rigid core values. Taking risk is considered as good in good times, while the opposite is the case when the cycle has turned. Then prudence is valued very highly, making it likely that a recovery with healthy risk taking is postponed. All this does not mean that nothing can and should be done to try to reduce instability without hampering progress and to reduce the costs of instability. But it does call for both modesty in the ambition of what can be achieved and modesty in changing culture and human motivation as a means to achieve a better outcome. It should also be taking into account that trying to engineer culture and morals too much can easily be counter-productive and lead to disaster.

2.4. THE ROLE OF BANKS IN SOCIETY

The role of banks in society has evolved over time. Banks have emerged to fulfil four core functions in the economy: providing credit, liquidity, payment services, and facilitating the functioning of financial markets. A market economy cannot thrive without these functions being fulfilled properly. The moral case for a market economy therefore also depends on a properly functioning monetary and banking system. Whatever the specific business model of banks is, these are therefore the core functions of the banking system.

Value is always created to individuals. Society as such is not an acting entity. It has no own ends. Speaking about the needs of society, as sometimes done by critics of the banks, is therefore misleading. It can lead to promoting or protecting the interests of particular groups, which happen to have the political majority in a certain period. It creates rent-seeking activities with inefficiencies as a result. By providing credit, banks play a decisive role in the allocation of resources in the economy. As Keynes (1936) has emphasised, they hold the key to economic expansion. Banks facilitate the growth of welfare in societies. Schumpeter (1942) has argued that they enable the constant restructuring of the economy.

Presenting banks as intermediaries has led to the misconception that banks just pass on saving surpluses in some sectors to sectors that have shortages and would like to invest. This is confusing saving and finance. When banks grant credit, they create money. That money when spent creates income and savings. Banks are and cannot be passive accommodators of what are called ‘the needs of the real economy’. The distinction between a real and monetary sector in the economy is not very helpful and may be misleading. A modern economy is an integration of both sectors. ‘The needs of the real economy’ do not exist autonomously. An economy is an organic system, where an element has only meaning in relation to other elements.

Their credit function means that banks have often to say ‘no’ to potential borrowers. This makes that throughout history banks and bankers have never been popular. That is not likely to change in the future. Neither should it, if banks are going to play their role properly. Introducing the concept of client centricity and putting emphasis on it may hamper value creation by banks if understood wrongly. If it is taken to mean that banks should passively honour any demand for credit, it will cause over-crediting and misallocations which may lead to stagflation and/or financial crises. To understand this is one of the great contributions of the Austrian school of economics and of Hayek in particular. The credit business is risky, by definition. As mentioned earlier, the future is uncertain. This uncertainty cannot be removed, no matter how good risk management is. Things can always turn out worse than hoped or expected. And risk management is not a hard, quantitative science, despite the impression one may get from looking at the models that are used (Blommestein, Hoogduin and Peeters, 2009). A bank can only add value by taking risk and facing uncertainty. A bank that does not take risk and that is afraid of uncertainty, does not do its
job and will turn out not to be viable. In the end, value can only be added and economic progress can only be made by taking the risk that value will be destroyed. And history tells us that this sometimes happens massively in financial crises.

Banks are providers of liquidity by supplying demand and saving deposits. This creates great value to economic agents. By holding part of their wealth in liquid form, agents do not have to commit themselves for a long period and remain flexible to respond to unforeseen opportunities or threats. Liquidity is a special option. And like all options it has value. It is special in that the owner can decide not only when, but also in what state of the world and for what purpose he will exercise the option. It is a valuable option to have in an uncertain world. Money and liquidity more generally support freedom. So the value of money is not only derived from its ability to reduce transaction costs. Bank deposits are only liquid if agents trust banks. This creates an inherent tension in the bank balance sheet. Credit provision cannot occur without taking

4 See Hayek (1931; 1933).

5 Uncertainty is different from risk. The latter can be quantified and managed. Uncertainty is a lack of knowledge about all possible outcomes of a decision. It cannot be managed, but only be dealt with. And it makes a difference how it is dealt with. This distinction goes back to Knight (1921) and Keynes (1921). See also Hoogduin (1987). For the role of uncertainty in Keynes’s economic theory, see Keynes (1936), pp. 109-124.

risk, but providing liquidity services means that the bank should be as safe as possible. This makes banks vulnerable to bank runs. The ways to cope with this tension that have evolved are deposit guarantee systems in combination with minimum capital and, more recently, minimum liquidity requirements for banks, and their supervision.

The minimum liquidity requirements do not go so far as to ask banks to back up their demand deposits for 100% with liquid assets. Would that not be desirable? One could also raise the issue of whether it would not be better to separate providing credit and liquidity services. I will come back to those issues later.

The provision of safe demand deposits automatically leads to a role of banks in the payment, clearing and settlement chain. That adds value: without such functions transactions would not be completed and the value inherent in the transaction itself would not materialise.

Due to their role in the payment, clearing and settlement chain, banks are highly interconnected. This has a positive and a negative side. The positive side is that adverse shocks can be spread broadly and thereby easily absorbed. The negative is that this is only true up to a point. For shocks beyond a certain size, the interconnectedness leads to amplification and a potential domino effect throughout the banking sector. The resulting financial instability can have a large negative impact on growth and employment which one would like to avoid. This may make banks too big or too interconnected to fail. And they need not always to be very big for that to be true.

Post-transaction services could be seen as part of public infrastructure supporting a market economy. That raises the issue of whether such functions should not be done by a public institution. The disadvantages of such a solution are that it may hamper innovations in these services and would lead to inefficiencies. It can also be questioned whether civil servants will manage the risks in the post trade services better than the private sector. Which sector has more skin in the game? The conclusion may be different from service to service also because the risks and potential for efficiency gains may be different for payment, clearing and settlement.

Finally, banks can facilitate transactions on financial markets by providing investment-banking services. This creates value, because without those services some value creating transactions would not take place.
6 Van Dixhoorn (2013) discusses four alternative monetary regimes: the so-called Chicago Plan, positive money, narrow banking and limited purpose banking.

7 See recent work in the complexity literature about financial instability, like Eisenberg and Noe (2001), Cifuentes, Ferruci, and Shin (2004), and several contributions in Abergel, Chakrabartie, Chakraborti, and Gosh (2012). For a general discussion of complexity, see Mitchell (2009).

Two issues have come to the fore. Should investment-banking services be combined with the other core banking functions? Does investment banking require more risk appetite than the other functions? And if so, is there a risk that decisions in the other parts of the bank will be infected by the risk appetite in the investment bank part? This leads to the issue of separation of retail and investment banking: back to Glass-Steagall or not?

Apart from assessing how important the risk mentioned in this context is, one also has to assess the benefits of universal banking. And this advantage mainly comes from diversification and, up to a point, economies of scale and scope. It has also to be taken into account that separate investment banks still can have a negative impact on retail banks, when they fail. Lehman Brothers was an investment bank after all. And finally: most financial crises had their roots in real estate. Providing mortgages is an activity mostly assigned to retail banking. Retail banks by nature are quite risky. On balance my conclusion is that reintroducing a distinction between investment and retail banking need not be high on the reform agenda.

The second issue is to what extent should proprietary trading by banks be allowed? Proprietary trading may create a conflict of interest between the client and bank. It may increase the risk of spreading too high a risk appetite and a too aggressive culture in the bank as a whole. It is also more difficult to see proprietary trading as a core value creating activity of banks. However, it is not so easy to make a sharp distinction between trading for clients and proprietary trading. And may proprietary trading, if well aligned with client trading, not also improve the services to clients by having skin in the game and being actively involved in the price discovery process?

This may point more in the direction of ensuring that proprietary trading does not become dominant and inconsistent with trading for clients. This is, for instance, proposed in the Liikanen report and supported by the Dutch Wijffels committee for the Dutch banking sector. It is also the view of the Dutch government which has taken over most of the recommendations of the Wijffels Committee.

2.5. THE GREAT FINANCIAL EXPANSION

Let me now turn to the financial crisis of 2007/2008. In my view, the start of the crisis marks the end of a remarkable era, which I call the Great Financial Expansion. That period probably had started in the late 1960s. The enormous expansion during this period was driven by developments in finance and monetary theory, deregulation and liberalisation, innovations in information and communication technology and the end of the Bretton Woods system of fixed but adjustable exchange rates.

During this period, we have seen a large increase in the size of the financial sector relative to other sectors in the economy and the economy as a whole. Several very big international banks emerged. Derivatives markets developed, enabled by the theoretical work of Black and Scholes (1973) and Merton (1973). The demise of the Bretton Woods system caused an increase in the volatility of financial markets. This provided an impetus to the development of derivatives markets.
It was a period in which central banks were made independent and were given the mandate to focus primarily on price stability. This was the result of the unhappy experience in the 1970s and the revival of monetarism under the leadership of Milton Friedman (1969). Central banks came to stand in the centre of economic policy. Inflation came down to levels in line with price stability and output volatility also decreased. All this was combined with continuous albeit not spectacular growth in advanced economies. It is understandable that this period was called the Great Moderation (Davis and Khan, 2008). Price stability was seen as an important contribution to financial stability. In the process of decreasing inflation, interest rates fell to historically very low levels. Since inflation was the main driver of interest rates, rapidly growing credit and asset prices were not seen as a reason to tighten monetary policy. Central banks at least accommodated the Great Financial Expansion, but probably were instrumental in triggering and sustaining this process.

The market came more and more to be seen as superior to government in generating welfare and progress. It was the time of Thatcher and Reagan. Deregulation and liberalisation also entailed removing barriers to the free movement of goods, services and capital. This contributed to the globalisation of markets and the growth of global trade. Emerging economies started their catching up process with the advanced economies. In China alone hundred of millions of people were elevated from poverty.

Financial markets were seen as self-correcting to a large extent. The efficient market hypothesis reigned. There was also the widespread belief that shareholders would prevent banks from taking too much risk. Risk management developed quantitative tools and came to be seen as a science. If risks were professionally managed, they were thought to be under control.

The emphasis on the power of self-correcting market forces prompted a relatively light-touch supervision of the financial sector. The presumption was that if individual banks were healthy the financial system would be stable. Banks were allowed to use their own quantitative models for assessing risk and capital requirements. There was no need to pay separate attention to the financial system as a whole. The internationalisation of finance was widely believed to have made the financial system more stable. Shocks to the system could be spread more widely. The financial sector became more interconnected, but on balance this was seen as a good thing. The apparent success of the financial sector and its apparent contribution to the economy may also have increased the risk and occurrence of regulatory capture. And it also triggered overconfidence, herding behaviour, greed and other human traits mentioned earlier to play their role in this financial boom process. The role of asymmetric and very high bonuses is a very visible aspect of this in the Great Financial Expansion.

The theory of finance had a highly micro character. It also made great contributions to asset management. The construction of portfolios was presented as finding an efficient combination of risk and return. Consistently outperforming the market was seen as very difficult, if not impossible. More and more the focus came on index investing and using the information of a limited number of rating agencies.

With hindsight, the period since the 1970s can be seen as the upward phase of a very long financial cycle. In the course of the great financial expansion banks became more vulnerable. Their leverage increased without much notice. Supervision was focused on risk-weighted capital requirements and did not pay much attention to leverage. But even risk-weighted capital buffers became very thin indeed and there were no harmonised liquidity requirements. And therefore there was also too little attention for this aspect of the condition of the financial sector. The size of banks and the financial sector relative to national economies had made the too big to fail problem more acute.

Financial institutions may have become more diversified during the Great Financial Expansion, but at the same time the financial system has become less diverse. Financial institutions used similar risk
models and used information from the same rating agencies and exposures became more similar, also because of worldwide diversification. In passing, I note that the irony is that they are likely to have made financial markets less efficient. Anyone familiar with the theory of complex systems would have been very worried by the combination of a highly interconnected system with low buffers and little diversity9. For instance, in biology it is well known that such systems may be very vulnerable. As said earlier, interconnectedness beyond some point is a shock amplifier rather than a shock absorber. The transition from a stable to an unstable regime can be abrupt and be triggered by a relatively small and local shock. This may be the role that the U.S. subprime residential mortgage market has played in 2007.

9 See the references in footnote 7. One may also want to look at: Mitchell (2009) and Haldane (2009), pp. 17-19 in particular.

2.6. BUSINESS MODELS

The Great Financial Expansion has come to an end with the most severe financial crisis since the 1930s, followed by a deep recession and a shallow recovery. This has been costly. Part of the value that seemed to have been created has turned out to be unsustainable. It is our duty to think about potential measures to make the banking system more resilient.

I reiterate that it is impossible to prevent all systemic risk and all crises, if we want to have welfare growth. There is a serious risk that the cause for being risk-averse will be overemphasised. It is also important to note that the impact of measures in a complex system like the banking sector can only be imperfectly predicted. There is always a possibility of unintended consequences. The more so, if many changes are made at once. An example in this context is the impact of measures in the banking system on the so-called shadow-banking sector.

Rational policy making can only be piecemeal, as argued by Popper in his concept of social engineering10. This implies that it is important to set priorities in taking measures to make the banking system more stable and that change is a process in which surprises will happen. Policy makers should be on guard for surprises and be prepared to learn from experience. And they should look at the financial system as a whole and not at banks or other financial institutions in isolation. In my view the most important measures for creating a more resilient banking system are: increasing capital and liquidity buffers, and ensuring that these buffers can be used to absorb shocks. And making it credible that any bank is resolvable not only involving shareholders, but also other creditors while minimising any contribution by the taxpayer. This requires agreement on resolution regimes and the drafting of so called living wills by systemically relevant banks. A workable living will may necessitate changes in the organisational and legal structure of a number of banks. The objective of writing living wills is to enable banks in resolution to continue to perform their core functions in order to avoid the usually high costs associated with a stand-still or bankruptcy.

Monetary policies around the world should be normalised11. Very loose monetary policy and so-called unconventional monetary policies may easily cause

10 Popper (1971) has introduced the idea of piecemeal social engineering.
11 This is close to the approach of the BIS; see Caruana (2013).

renewed financial instability and/or inflation in the longer term. And they reduce pressure on banks to restructure. In the worst case this creates Zombie banks, or keeps already existing Zombie banks in business12. An unhealthy banking sector hampers innovation, productivity growth and economic growth. Banks do not contribute to value creation as much as they could.

As there is still doubt about the soundness of the European banking system, a credible and swift restructuring operation is highly urgent. Without a healthy financial system, there will be no sound
economic recovery and sustained value creation in society. It is high time to resolve legacy issues if and where that has not been done sufficiently yet. This requires a transparent and realistic valuation of banks’ balance sheets, credible stress tests, mandatory recapitalisation, and restructuring and resolution procedures. It finally requires government debt to be made sustainable.

Basel III is a step in the right direction. However, even after full implementation capital buffers remain too low for feeling comfortable. They should be increased further. Moreover, the Basle Committee has recently started a consultation to discuss the balance between simplicity, comparability and risk sensitivity of the capital requirements. My view is that Basel III is too complicated and too ambitious in determining risk weights. This points towards a more prominent role for the leverage ratio in setting capital requirements (Haldane, 2012).

What about monitoring and promoting the right culture and ethics in a bank? I would not spend a great part of supervisory resources on this topic. As argued earlier, norms and ethics are deeply rooted in human nature and cannot be changed at will. And focusing on risk aversion can easily be overdone in the aftermath of this crisis. Some of the norms that supervisors like banks to follow can even be counterproductive. Earlier I mentioned promoting ‘client centricity’ in the context of a bank’s credit business as an example. It seems to be difficult to really monitor and assess the internal culture of a firm. It is clear that in the run up to the crisis, bonus systems were too asymmetric. This has been largely corrected. I would now pause and see how the taken measures play out.

Additional taxes on the banking system are not good policy. For a large part they will be passed on to the clients and to the extent they are not, they hamper the necessary further deleveraging of the banking system. And supervisors should not be too shy in setting the pace for further reducing leverage. Hellwig and Admati (2013) are right in stressing that the costs of reducing leverage, if any, are mainly private. Paul Tucker, the outgoing deputy governor of the Bank of England, somewhat nuances the analysis of Hellwig and Admati but agrees with their core conclusion (Tucker, 2013).

Should regulators directly interfere with banks’ business models? I do not think that this is a good idea. The priority measures that I have mentioned have an important impact on the framework in which banks have to operate. They change the rules of the game. Finding business models in that new era after the Great Financial Expansion to provide the old core functions is a task best left to banks themselves in the market process. That is the least imperfect discovery procedure for that type of questions we have available to use the words of Hayek (1978b). However, this implies that one direct intervention is warranted. Where banks have been nationalised after the financial crisis, they should be privatised again. And banks that have received capital injections should repay this support as soon as prudently possible.

And there is one other intervention that is worth considering. That is nationalising the post-transaction infrastructure, i.e., payment, clearing and settlement. I have not yet reached a firm conclusion on whether that is desirable.

For the moment, I give the benefit of the doubt to using market forces in this area too, because of their role in promoting efficiency and innovation. Regulators and supervisors better not interfere with issues such as whether it is better to separate investment and retail banking, whether it is right for universal banks to do proprietary trading at all, separate the credit and liquidity function.
of banks and 100% reserve banking.

The first two of those issues have been discussed earlier. Separating the credit and liquidity function of banks, as for example proposed in the Chicago Plan, would make an independent authority or the government responsible for all liquidity creation. This can only work when the demand for liquidity is stable. The quantity theory of money should hold in the medium term that is relevant to monetary policy. The existence of fundamental uncertainty make it unlikely that this is the case, as history has shown. Liquidity creation can therefore also better be the outcome of a process, in which the central bank steers a short-term interest rate and the banking sector creates liquidity. 100% reserve banking would be problematic for the same reason.

It has been argued that banks may have become too complex to manage. This may be true. But I would leave it to the market process to correct that. It may well be that improvements can be made in dealing with complexity. The market process is a better procedure for discovering if that is true than making prescriptions for the size of banks.

2.7. CONCLUSION

The best way forward seems to be pursuing the key priorities that I have mentioned:
– make the banking sector healthy rapidly where this is not yet the case, in parallel with putting government debt on a sustainable path;
– increase capital and liquidity buffers further over time after the Basel III objectives have been reached;
– ensure that these buffers can be used when needed;
– put greater emphasis on the leverage ratio as a measure of banks’ required capital;
– create credible resolution regimes in combination with workable living wills;
– and at the same time allow for different bank business models to be tried and flourish;
– normalise monetary policy.

This set of policies seems to give the best chances of making the banking sector instrumental in the recovery from the worst crisis in eighty years and to be of best value to all of us.

REFERENCES
De financiële sector als groeisector

1. Introductie

2. Onze groeiambietie
* VNO-NCW heeft de ambitie om van Nederland het meest welvarende land ter wereld te maken. Wij denken dat Nederland alles in huis heeft om dat te bereiken. Er is ongekend veel ondernemerschap in Nederland, meer dan ooit te voren. En we hebben vele sterke sectoren waarmee we in de wijde wereld nog veel meer mooie producten - goederen en diensten- dan nu kunnen leveren. We spreken dan over Grenzeloze Groei. Met de wereld als afzetgebied zijn er mogelijkheden te over. Die ambitie van meest welvarende land ter wereld is economisch, maar vooral ook maatschappelijk geïnspireerd. Als je welvarend bent, dan zijn er banen en creëer je ook de basis voor een land dat mondiaal wordt herkend en erkend door zijn aantrekkelijk, tolerant en uitdagend leefklimaat.
* De vraag vanavond is wat de rol van de financiële sector in een groeiplan voor Nederland kan zijn. Moet U uitsluitend een -natuurlijk voortreffelijke- dienstverlener zijn voor de Nederlandse reële economie, die het geld dan maar moet verdienen. Of kunt U net zo goed een groeisector zijn, door net als andere topsectoren met sterke dienstverlening de internationale markten te bedienen. Om het wat scherp tegenover elkaar te zetten : gaat U voor een nutsperspectief of een ondernemend groeiperspectief?
* Tien jaar geleden, in 2005, twijfelde niemand eraan dat de financiële sector een topsector was : een sector met een rijke traditie, waar geheel Nederland van links tot rechts trots op was. Op aandringen van minister Wouter Bos is in 2007 nog Holland Financial Centre opgericht, een eigen publiek-private club om de Nederlandse financiële sector op het internationale niveau een prominente plaats te laten behouden. De ambitie? Na London moest Nederland het belangrijkste financiële centrum in Europa zijn. Laatst werd mij uit onverdachte bron nog toegefluisterd dat de Nederlandse financiële sector internationaal inderdaad toonaangevend was, vooral vanwege zijn innovatievermogen. Ik zeg expres toegefluisterd, omdat het blijkbaar niet meer gepast is, zo met trots over de sector te spreken.
* Het is evident dat de wereldwijde financiële crisis ook een stevige impact heeft gehad op de Nederlandse financiële sector. En natuurlijk is er leergeld betaald voor onevenwichtig handelen bij diverse spelers, maar wanneer we de zelfstandige groeikracht van de financiële sector niet op waarde schatten, maken we écht een fout. Een econoom zou zeggen dat we onze comparatieve voordelen moeten uittunen. En dat is onze financiële sector - in brede zin : banken, verzekerings, pensioeninstellingen, private equity, trustsector, etc.-. Is het in het zevende jaar na de val van Lehman Brothers geen tijd om weer ambitieus te durven zijn ? Daarvoor wil ik vanavond een pleidooi houden. Lat ik beginnen door vijf waarnemingen met U te delen, daarna elementen van een toekomstperspectief schetsen, en tenslotte stil staan bij de vraag wat tussen droom en daad in de weg staat.

3. Vijf waarnemingen over de financiële sector als groeimotor
A. Dubai : 1990-2002-2013 (drie foto’s) : hoe de financiële sector een groeimotor is.
Even een uitstapje naar buiten. Ter illustratie van de financiële sector als groeimotor.
o Dubai in 1990 : een kale vlakte, de rijkdom werd nog voornamelijk verdiend met de olie-inkomsten.
o Dubai 2002 : het zakencentrum wordt opgebouwd, maar nog steeds een bouwput.
o Dubai 2013 : de financiële centrum van het Midden-Oosten !


B. Nederland : 1611-2008: de financiële sector was gewoon een topsector
Nederland kent een rijke financiele historie van meer dan 400 jaar. Bijna vierhonderd geleden – in 1611 - ontstond vanuit de behoefte om de scheepvaart naar „De Verre Oost“ te financieren de eerste echte kapitaalmarkt ter wereld: de Amsterdamse beurs. Door de jaren heen heeft de financiële sector bijgedragen aan de internationale expansie van ons bedrijfsvleven door bedrijven over de hele wereld bij te staan met hoogwaardige dienstverlening. Waar Heineken Amerika veroverde, Shell pionierde in Rusland en het Midden Oosten, is de financiële sector hen gevolgd. Ons bedrijfsvleven is in haar expansie goed bediend door ons financiële en zakelijk dienstencomplex. Niet alleen door het adviseren en het financieren van fusies en overnames, maar ook door een rol te spelen in de handelsfinanciering. Zonder concurrerend exportkrediet en exportverzekeringen hadden we nooit kunnen uitgroeien tot het handelsland dat we nu zijn.

De productiviteit per uur ligt 2,5 keer hoger dan gemiddeld in de Nederlandse economie. Dat levert dus grote verdiensten op, veel meer dan met vele andere takken van sport. Tot 2008 vonden we het slim om met deze hoogproductieve activiteiten grote afzet, juist ook buiten Nederland, te genereren. Daarna lijken we in "Small is Beautiful" te zijn vervallen.

C. Nederland 2015 : financiële sector op beklaagdenbank, maar nog altijd geweldig groeipotentieel

We moeten met een open blik kijken naar waar we goed in zijn en dat benutten !
Ik heb afgelopen tijd een rondgevraagd waar de Nederlandse financiële sector nu écht goed in is. Een kleine opsomming van wat ik opving:
* Op het gebied van agro&foodfinanciering zijn wij nog steeds een partij waar je wereldwijd niet omheen kunt.
* We leveren zeer hoogwaardige kwaliteit op het gebied van private banking, handelsfinanciering, high frequency trading.
* We hebben het beste en goedkoopste betalingsverkeer ter wereld.
* We hebben een enorm veelzijdige verzekeringsector, die in staat is om risico’s bijna elke economische activiteit af te dekken.
* En onze trustkantoren maken met hun excellente dienstverlening mogelijk om geldstromen bij bedrijven te optimaliseren. Nederland heeft helemaal niet de bedoeling om met fiscaal trapezewerk maximaal bij te dragen aan profit shifting naar belastingparadijzen. Van dat imago dat ons wordt aangewreven, moeten we zelfs helemaal af. Wat dan onder de korenmaat blijft is de kwaliteit van de dienstverlening. Hoe kunnen we sectoren beschuldigen van excellente dienstverlening?
* Ook hebben we een van de beste pensioenstelsels van de wereld, met veel kennis en hoogwaardige werkgelegenheid. De bestaande uitkeringsovereenkomst moet weliswaar worden gemoderniseerd, daar laten sociale partners teveel liggen. Maar aan de pensioenexpertise bij de grote pensioenuitvoerders ligt het niet. Dat zijn ‘sleeping beauties’ voor afzetgroei op buitenlandse markten. Waarom de goede pensioenconcerns niet veel meer op de buitenlandse markten actief worden, ontgaat me.

D. Financiële sector : Piketty proof : bij uitstek geschikt om te profiteren van de sterkere groei in de wereldwagelconomie

De pensioensector geeft wel op een andere wijze een les. Men heeft ruim voor de analyse van de heer Piketty begrepen dat R groter is dan G. Beleggingsrendementen zijn door te profiteren van de mondiale economie groter dan de economische groei in Nederland. Wij vinden zelfs dat de pensioensector met dat inzicht wat overdrijft door de Nederlandse hoorn waaruit ze drinken, teveel links te laten liggen. De juiste balans moet altijd worden aangehouden! Maar wat men ondertussen wel illustreert, is dat juist de financiële sector bij uitstek geequipeerd is om in te spelen op de mondiale groei. En daarmee kan je veel welvaart naar Nederland halen. Blijven we in Nederland nu steken op een groei van een mager procentje, de wereldwagelconomie groeit dit jaar met 3,5 procent en het handelsvolume zelfs een vier procent.

E. Nederland op 1 qua welvaartspositie: grenzeloos groeien: de wijde wereld in !

Waarneming 5 is een open deur van jewelste. Wil Nederland meekomen en het meest welvarende land van de wereld worden, dan kunnen we niet volstaan met het bedienen van 17 miljoen mensen. Dat moet natuurlijk excellent gebeuren, we willen goed worden bediend. Maar voor een land waarvan nu al een derde van het nationale inkomen komt uit het buitenland, is het geen nieuws dat de blik ook naar buiten moet. Deze les uit het verleden, moet nu een gebod worden. Elke activiteit en sector, zelfs de zorgsector en het onderwijs, heeft de dure plicht om zich af te vragen of ze er in het buitenland ook geld mee kunnen verdienen. Voor een sector als de financiële sector moet dat geen issue zijn.

3. Wat moet er gebeuren? Wat zijn de mogelijkheden ?

Dames en heren. Met een historie van meer dan 400 jaar kan het niet zo zijn dat 7 magere jaren ons stekeblind maken voor de betekenis van de financiële sector voor de welvaart in Nederland. Zeer onterecht is de financiële sector enige jaren geleden afgeserveerd als een van de topsectoren van ons land. We moeten nu gewoon weer erkennen en herkennen dat de financiële sector een topsector is en als zodanig behandeld moet worden.


* Innovatie en productvernieuwing zijn voor de financiële sector van onverminderd groot belang, en misschien nog wel belangrijker door de toenemen transparantie en afrekenkultuur. De IT-revolutie, de grote gamechanger, zal ook de businessmodellen in de financiële sector op zijn kop zetten. We hebben daarvan nog maar het begin gezien. Wie niet meegaat in de digitale wereld, heeft geen toekomst. Uitdagers te over. Zie bijvoorbeeld Google, die bepaalde bancaire activiteiten wil
gaan ontploffen. Dat kunnen we niet tegenhouden, maar moeten we ook niet willen tegenhouden. Met digitaal bankieren – de mooie apps- lopen de Nederlandse banken gelukkig voorop.

* Met Big Data moet en kan banken weer de ruimte worden geboden om weer te kunnen financieren op basis van verdienpotentieel van klanten. Met financiering louter op basis van de financiële track record van klanten in het verleden, op basis van gerealiseerde financiële kengetallen, vindt financiering plaats door de achteruitkijkspiegel. Daarmee draagt U niet bij aan de nieuwe groei. En dat moet wel.

* De mogelijkheden liggen er. Met het grootste internetknooppunt ter wereld in Amsterdam en onze goede dataprotectie hebben we „goud” in handen om als eerste de vernieuwing aan te gaan en daarmee marktaandeel te winnen. Vertrouwen is in de digitale omgeving een sleutelelement. Met een internetknooppunt met de aller veiligste technologie binnen handbereik kan Nederland zich als financieel knooppunt weer op de kaart zetten...zoals het vroeger was : “Alles kan hetzelfde blijven, wanneer je maar verandert”

* Daar hoort voor mij ook bij om te onderzoeken in hoeverre de commoditytrading – de handel in grondstoffen – die nu vooral in Zwitserland plaatsvindt, te koppelen aan deze excellente ICT-infrastructuur. Daarmee zouden de daadwerkelijke grondstoffenstromen die onder meer door de Rotterdamse haven lopen kunnen worden verbonden met de handel en de financiële afwikkeling ervan. Voor de trustsector een nieuwe kans?

* Ik zie tegelijkertijd heel goed dat het financieringslandschap veelzijdiger moet worden dan nu het geval is. Meer mogelijkheden voor risicodragende financiering buiten het bankwezen om. Waar nu 80 % van de mkb financiering via de banken gaat, moet dat meer evenwichtig naar zeg 60 %. Dat betekent ook:
  - ruim baan voor private equity -de participatiemaatschappijen-;
  - bouwen aan een bredere en diepere kapitaalmarkt met de beurs;
  - veel ruimte voor securitisatie, met rating van MKB leningen op basis van SBR;
  - echt ruimte geven aan platforms als kredietunies en crowdfunding.

Hierover moeten we het met elkaar hebben op de Ondernemingsfinancieringstop die we deze lente organiseren met MKB Nederland en de NVB. Zo kunnen we inspelen op de zg. Kapitaalmarktunie, waaraan in Brussel wordt gewerkt. Op één been –die van de Bankenunie- is het moeilijk staande te blijven.

*In de verzekeringsector heeft de digitalisering al geleid tot meer transparantie en daarmee een intensievere concurrentie op kwaliteit en prijs van producten. Maar daar zijn we er nog niet mee. Ik ben dan ook blij om te zien dat het Verbond van Verzekeraars het initiatief tot een Innovation Lab heeft genomen, dat later dit jaar geopend zal worden. Daarmee wordt de modernisering van de sector aangejaagd.

* De pensioensector heb ik net al de „sleeping beauty” genoemd. Nederland heeft hier zeer veel expertise, maar de innovatie gaat te langzaam. Dat heeft alles te maken met de inrichting van het pensioenstelsel, en de regulering. Maar de sector zelf mag de schrook ook afschudden. Als voorbeeld noem ik het eigen huis waar nu met het verplichte aflossen huiseigenaren massaal vermogen gaan opbouwen. Met vernieuwende producten kan dat vermogen worden omgezet in pensioeninkomen. Ik roep de pensioensector op met nieuwe innovatieve pensioenproducten te komen, die beter toegesneden zijn op de uiteenlopende individuele pensioenbehoefte. Dat kan mooi producten opleveren, die wereldwijd af te zetten zijn.

Mijn tweede spoor gaat over internationalisering.

We hebben dus world class kennis heb ik mij laten vertellen. Waarom bouwen we daar dan niet op voort? Waarom zoeken we het niet nog meer in het buitenland?

Willen we van de financiële sector weer een internationaal bloeiende sector maken, dan moet het roer wel om en moeten we de financiële sector weer waarderen als een kracht van de Nederlandse economie. Natuurlijk hoort daar bij dat de klant centraal moet staan. Eigenlijk bedoelen we dan te zeggen dat de financiële producten niet voor verrassingen moeten zorgen bij klanten. Voor elke
onderneming geldt dat er “value for money” moet worden geboden. Maak daar als Nederlandse financiële sector een handelsmerk van. Juist dan is er alle ruimte om internationaal te expanderen.

Daarbij moeten we ook inzetten op een strategie die bedrijvigheid naar Nederland haalt. Door concurrerende wet- en regelgeving die niet verder gaat dan wat Europa wil, door efficiënt en slim toezicht, en door ondernemers de ruimte te geven om te ondernemen. We moeten de sector juist als enorme winstpost zien in plaats van een verliespost. De stuwende kracht van een sterke financiële sector kan enorm zijn. En dan praat ik over bedrijvigheid, banen en welvaart.

4. Waar moeten we mee ophouden ?
Groeibelemmeringen. Ik tref echter helaas de afgelopen zeven jaar veel groeibelemmeringen aan voor de financiële sector. De financiële crisis heeft geleid tot een regelgevingsreflex vanuit de overheid en de toezichthouders om maar controle proberen te krijgen op de sector.
Na de crisis stonden overheid en toezichthouders voor de opgaven de checks and balances opnieuw in te richten. Natuurlijk heeft de financiële crisis terecht geleid tot een beter framework voor beheersing van macro-risico’s. Aan het voorkomen van financiële zeepbellen die uit elkaar spatten en groot leed veroorzaken, moet natuurlijk veel aandacht voor zijn. Vergroten van het weerstandsvermogen van banken, verzekerings- en pensioenfondsen is op zich prima. Dat doe je echter makkelijker vanuit groei dan vanuit krimp. Dat is een kwestie van time management. Ik ben de laatste die zou willen beweren dat dit beleid allemaal onzinnig is.
Waar ik tegen ageer, is wanneer het ontstaat in gedetailleerde micro-regulering en toezicht. Dat haalt het verdienvermogen van de sector onderuit. Zo wordt het paard achter de groeiwagen gespannen. We moeten een nieuw evenwicht zoeken tussen de ruimte om financieel te ondernemen en de goede checks en balances om maatschappelijke risico’s af te dekken.
Want wat de afgelopen jaren gebeurd is. lijkt sterk op een strafexpeditie voor de financiële sector. Ik noem een paar voorbeelden:
* De bankbelasting is een strafeffing op de sector zonder dat daar rationele gronden voor zijn..
* Met de wet beloningsbeleid neemt de overheid een deel van het HR-beleid van de sector in handen, en gaat daarbij nog eens verder dan andere landen en Europa. We hebben de strengste wet van Europa. Dat moet het je niet verbazen dat talent niet meer voor Nederland kiest.
* Het aannemen van mensen wordt ook door de toezichthouder geregeld in de vorm van de geschiktheids- en integriteitstests. Blijkbaar zijn ondernemingen zelf niet meer in staat om te kijken wie er geschikt is om in de board van de onderneming te gaan zitten. Ambtenaren van de toezichthouder gaan zeer subjectief beoordelen of iemand “authentiek” en “omgevingssensitief” is en zijn of haar “morele kompas op orde” is. Wanneer straks op basis van nieuwe wetgeving de toezichthouder mensen tijdelijk mag gaan schorsen, is het hek helemaal van de dam. Wie wil aandeelhouder zijn van een onderneming waarvan de leiding door buitenstaanders op elk moment van de dag van hun job kunnen worden gehaald ?
* We gaan met deze maatregelen stelselmatig verder dan Europese wetten, waardoor de Nederlandse financiële sector erger wordt aangepakt dan in het buitenland. Nationale goldplating. Niet alleen verstoort dit het level playing field van onze eigen bedrijven, ook het vestigingsklimaat en de concurrentiekracht worden zo ondermijnd.
Met een stortvloed aan complexe wet- en regelgeving maak je het de sector al moeilijk om de binnenlandse economie te faciliteren, laat staan dat we toekomen aan internationale expansie. En daarmee schieten we onszelf in de voet. We laten kansen op groei onbenut, kansen voor welvaart. We moeten nu eens ophouden met het bashen van de financiële sector. De mindset bij politieke beleidmakers is verkeerd. De financiële sector wordt nog steeds weggezet als “malign” en niet als “benign”.

5. Samen de schouders er onder!
Tot 2007 hebben we vierhonderd jaar lang een internationaal toonaangevende financiële sector gekend. Maar in de nadagen van de financiële crisis hebben we de afslag met London en Dubai
gemist. We hebben van de neergang geleerd. Er is vanuit de sector zelfreinigend vermogen ontstaan. En daar was ook alle aanleiding toe. Maar nu moeten we dóór. Door met financieel ondernemen, met innovatie en groei. Omdat we daar enorm goed in zijn en er potentieel ligt om aan te haken bij de mondiale groei. De financiële sector is een topsector en moet bijdragen aan een land dat door zijn welvaart, internationale oriëntatie en leefklimaat een mondiaal onderscheidende positie verwerft. Daar hoort een herkenbaar toekomstscenario bij. Samen de schouders er onder. VNO-NCW wil de totstandkoming daarvan graag voor U in de vertrouwde Malietoren faciliteren.

Hans de Boer, 24 februari 2015
Bankers Lie. So Does Everyone Else.

Leonid Bershidsky

A paper in the prestigious journal Nature (see below**) shows that bankers tend to lie and cheat in their professional roles. This conclusion seems so obvious that the researchers from the University of Zurich who came up with it could almost be candidates for the Ig Nobel Prize. The idea has another problem: the phenomenon they describe has more to do with the power of money in general than with just the culture of the financial industry.

Alain Cohn and his two collaborators used a standard method for gauging people's propensity to cheat. Subjects are asked to roll dice -- or, in the Swiss study, flip coins -- and try to guess the outcome for a cash reward. The trick is that the subjects report the outcomes themselves. On average, with 10 tosses of a coin, there is a 50 percent chance it will land either heads or tails each time. A subject who reports beating those odds is probably lying.

In the Swiss experiment, 128 bankers were split into two groups. Members of one group were asked neutral questions about their daily lives; those in the other had to answer specific queries about their banking experience. The first group reported that it had guessed heads or tails on 52 percent of the tosses. For the second group, the average was 58 percent, and a 10th of these bankers claimed the maximum possible $200 reward; that kind of luck is almost impossible.

When the researchers played the game with professionals from the pharmaceutical and tech industries, people who were asked about their work were as honest as those who were asked neutral questions. That was the basis for the researchers' finding that "the prevailing business culture in the banking industry weakens and undermines the honesty norm, implying that measures to re-establish an honest culture are very important."

That conclusion, however, is probably flawed. In 2002, the Israeli behavioral economist Uri Gneezy showed that the decision whether to lie is a trade-off between the benefit to the decision-maker and the cost to others. As the payoff grows, it increasingly outweighs the altruistic consideration.

Gneezy proved this by playing a "salesperson game" with his subjects:

You wish to buy a new vacuum cleaner. There are two vacuums you are considering. Consulting with a salesperson she recommends one “because it is better.” Should you follow the advice? Maybe she is paid a higher commission for this product, and that is why she recommends it? Similarly, imagine that you go to a tourist’s restaurant and the waiter recommends the lobster. Are you going to follow her recommendation? If you think the waiter recommended it because she thinks it is better, you would. But what if she recommended it simply because the cook told her that the lobster is not fresh, and must be sold today? When are the salesperson and the waiter more likely to lie?

The "waiter" or "salesperson" in the game correctly assumed her advice would be followed, and chose to lie either when the "customer" didn't stand to lose too much from the bad information or when her payoff from lying was sufficiently high.
"The implications of the above is illustrated by the purchase of a car: You can trust what the seller says about the condition of the brakes more than what she says about the state of the air conditioning," Gneezy wrote.

The Israeli researcher also asked his subjects about the acceptability of lying in certain situations. Many agreed that it was generally admissible to deceive a big, wealthy institution such as a bank or an insurance company. For example, 11 percent said that it was "almost always acceptable" to allow a doctor or a lawyer to submit bills to an insurance company for services they hadn't rendered. Gneezy concluded that "people are more accepting of fraudulent behavior toward large organizations or rich counterparts than towards an individual: The monetary cost may be identical, but the damage to the individual is perceived as greater."

Gneezy's subjects were students. Some may have become bankers. I doubt that changed their behavior too much. It isn't the culture of banking that creates incentives to lie. Deceptive behavior carries bigger rewards in the financial industry simply because bankers deal in large amounts of money, and their counterparties are often big institutions -- regulators, funds, wealthy clients and governments. It isn't just bankers who would lie, or condone lying, in that context.

To test my hunch, the Swiss researchers would have needed to play their coin game with people in other industries who face potentially high rewards for lying, say tech start-up managers or government officials. Or journalists, for that matter: Stephen Glass must have found the returns of lying were an acceptable trade-off for the damage his lying inflicted on others, and he was cheating an institution -- his employer, the New Republic.

You can't fix human nature with ethics codes or by preaching about cultural change. The only way to get bankers, or people in any profession, to be more honest is to minimize the gain from lying, and establish a higher financial reward for ethical behavior.

http://www.nature.com/nature/journal/v516/n7529/full/nature13977.html
Nature 516, 86–89 (04 December 2014)

**Business culture and dishonesty in the banking industry**

*Alain Cohn, Ernst Fehr & Michel André Maréchal*

Trust in others’ honesty is a key component of the long-term performance of firms, industries, and even whole countries. However, in recent years, numerous scandals involving fraud have undermined confidence in the financial industry. Contemporary commentators have attributed these scandals to the financial sector’s business culture, but no scientific evidence supports this claim. Here we show that employees of a large, international bank behave, on average, honestly in a control condition. However, when their professional identity as bank employees is rendered salient, a significant proportion of them become dishonest. This effect is specific to bank employees because control experiments with employees from other industries and with students show that they do not become more dishonest when their professional identity or bank-related items are rendered salient. Our results thus suggest that the prevailing business culture in the banking industry weakens and undermines the honesty norm, implying that measures to re-establish an honest culture are very important.
Regulierung der Finanzbranche: "Der Bankensektor muss schrumpfen"
Interview Martin Hellwig
Von Stefan Kaiser und Christian Rickens

Europas Geldhäuser sind viel zu hoch verschuldet, warnt der Finanzexperte Martin Hellwig. Im Interview erklärt er, warum die Institute deutlich strengere Regeln brauchen - und warum Politik und Aufseher trotzdem lieber auf die Bankenlobby hören.


Hellwig und Admati fordern eine radikale Reform der Bankenregulierung. Sie wollen die Institute zwingen, sich deutlich mehr durch Eigenkapital zu finanzieren und deutlich weniger über Schulden. Im Interview erzählt Hellwig, warum sich die Politik mit solchen Reformen so schwertut, wie stark die Macht der Bankenlobby ist und wo in Deutschland die größten Wackelkandidaten sitzen.

SPIEGEL ONLINE: In Ihrem Buch "Des Bankers neue Kleider" gehen Sie und Ihre Co-Autorin Anat Admati hart mit der Finanzbranche ins Gericht. Wie haben die Banker darauf reagiert?

Hellwig: Ich habe nicht so viel mit Bankern zu tun. Anat Admati, die als Professorin in den USA lehrt, hat viele Banker getroffen, die ihr gesagt haben, dass wir völlig recht haben. Aber natürlich auch andere, die ihr widersprechen.

SPIEGEL ONLINE: Sie kritisieren in Ihrem Buch vor allem die hohe Verschuldung der Banken und fordern, die Institute müssten deutlich mehr eigene Mittel einsetzen. Die weltweiten Finanzaufseher sind da viel vorsichtiger und haben die Eigenkapitalanforderungen nur leicht erhöht. Liegen die denn alle falsch?


SPIEGEL ONLINE: Aber auch Banker müssen doch ein Interesse daran haben, dass ihre Bank nicht beim ersten Krisenhauch zusammenbricht.

Hellwig: Je höher die Verschuldung, desto größer ist das Rad, das man dreht. Wenn man damit einige Jahre Glück hat, so kann man sehr viel verdienen. Und hat man Pech und die Bank kommt in Schwierigkeiten, so hilft vielleicht der Staat. Dieser Too-big-to-fail-Faktor bedeutet einen erheblichen Wettbewerbsvorteil. Wenn alle erwarten, dass der Staat die Bank nicht pleitegehen lässt, kann sie sich sehr billig verschulden - auch deshalb ist das Schuldenmachen für Banken so attraktiv.

SPIEGEL ONLINE: Die Banken warnen, sie könnten die Wirtschaft nicht mehr ausreichend mit Krediten versorgen, wenn sie so viel Eigenkapital einsetzen müssten.

SPIEGEL ONLINE: Die Regulierer wollen eine Untergrenze für das Eigenkapital bei drei Prozent der Bilanzsumme festsetzen. Sie fordern dagegen 20 bis 30 Prozent. Warum sind Sie denn so sicher, dass das die richtige Größe für das Eigenkapital ist?


SPIEGEL ONLINE: Aber warum sollen es ausgerechnet 20 bis 30 Prozent sein?

Hellwig: Wir maßen uns da keine Präzision an. Wir orientieren uns an dem, was es vor dem Ersten Weltkrieg gab - also bevor der Staat den Wunsch entdeckte, von Banken finanziert zu werden und bevor es staatliche Sicherungssysteme für Bankengläubiger gab. Im Jahr 1913 haben sich die deutschen Banken im Durchschnitt zu 22 Prozent aus eigenen Mitteln finanziert.


SPIEGEL ONLINE: Inwiefern?

Hellwig: Wenn die Banken schwach sind, muss die Europäische Zentralbank ihnen billige Kredite geben, um einen Zusammenbruch des Geldsystems zu vermeiden. Und die Banken verleihen das Geld weiter an ihre Regierungen. Bei einem EZB-Zinssatz von einem Prozent und Zinsen auf die Staatsanleihen von vier, fünf oder sechs Prozent ist das sehr profitabel. So finanziert die EZB die Mitgliedstaaten indirekt. Die direkte Finanzierung ist ja verboten.

SPIEGEL ONLINE: Anfang 2014 will die Europäische Zentralbank ihre Bilanzprüfung bei 130 europäischen Banken starten. Wird das die Probleme offenlegen und vielleicht sogar lösen?

Hellwig: Das ist die 100-Milliarden-Euro-Frage. Der EZB muss daran gelegen sein, dass alle Probleme bereinigt werden, bevor sie die Verantwortung für die Bankenaufsicht übernimmt. Einige Mitgliedstaaten wollen das eher nicht, denn vielleicht müssten sie dazu viel Geld aufbringen.
SPIEGEL ONLINE: Gilt das auch für die Bundesregierung?

Hellwig: Die Bundesrepublik will im Großen und Ganzen, dass die Prüfung seriös sein soll. Allerdings hätte man es vielleicht auch lieber, wenn die Prüfer bei bestimmten deutschen Banken nicht ganz so genau hinsähen.

SPIEGEL ONLINE: An welche Banken denken Sie da?


SPIEGEL ONLINE: Wie muss sich die Bankenlandschaft verändern?

Hellwig: Der Banksektor muss insgesamt schrumpfen, sonst kommen wir aus dem Schlamassel nicht raus. Wenn es zu viele Banken gibt, müssen sie zocken, um überhaupt über die Runden zu kommen. In dem Punkt haben wir gerade in Deutschland zu wenig getan. Die einzige Bank, die wirklich abgewickelt wurde, war die WestLB - und das auch nur auf Druck der EU-Kommission. Insgesamt ist das Bankwesen in Relation zur Wirtschaftstätigkeit in Europa deutlich größer als in den USA. Das ist auch eine Folge des Irrglaubens, dass jedes Land, das etwas auf sich hält, mindestens eine große Bank haben muss.

SPIEGEL ONLINE: Die Staaten sollen also Banken dichtmachen?


SPIEGEL ONLINE: Sie sind nicht nur Wissenschaftler, sondern beraten auch die Politik. Haben Sie das Gefühl, dass Sie dort mit solchen Positionen Gehör finden?

Hellwig: Als Mitglied des Europäischen Systemrisikoausschusses habe ich sehr viel mit diesen Themen zu tun und versuche auch sehr stark, meine Vorstellungen einzubringen. Allerdings ist völlig klar: Da geht es um knallharte Interessenvertretungen der Nationalstaaten. Wir versuchen dort zwar deutlich zu machen, was die Risiken sind, ich habe aber keine Illusionen über die Wirkung, die das hat.

SPIEGEL ONLINE: Haben Sie den Eindruck, dass die Politik auf die Vertreter der Banken besser hört?

Hellwig: Das sowieso. Für die Politik sind Banken eine Quelle von Geld und nicht eine Quelle von Risiken. Und so arbeiten Regierungen, Zentralbanken, Bankenaufsicht und Geschäftsbanken eng zusammen.
ETHISCHE FUNDIERUNG VON MANAGEMENTVERGÜTUNGEN IN DER KREDITWIRTSCHAFT
(Juli 2013)

I. Präambel

- Die ethische Fundierung von Managementvergütungen entwickelt sich zu einem unverzichtbaren Faktor für eine nachhaltig erfolgreiche Kreditwirtschaft.


II. Kernbotschaften

- Die Managementvergütung ist nicht nur an messbaren Faktoren und Kennziffern auszurichten, sondern erfordert eine ethische Fundierung.
- Gemeint ist eine Orientierung unternehmerischen Handelns, die nicht allein kurzfristige Gewinne, sondern vielmehr die langfristigen Bedingungen für dauerhaft erfolgreiches Wirtschaften in den Blick nimmt. Dazu zählt für jedes Unternehmen unmittelbar die eigene Vertrauenswürdigkeit und mittelbar das Vertrauen der Menschen in die Branche und die Soziale Marktwirtschaft im Allgemeinen.

- Eine ethisch fundierte Managementvergütung muss Eingang in die unternehmensspezifischen Zielvereinbarungen und Leistungsbewertungen finden und erfordert:
  - Jede Vergütung muss grundsätzlich nachvollziehbar einer entsprechenden Leistung gegenüber stehen.
  - Entscheidend für die Leistungsbeurteilung ist insbesondere auch das Handeln nach unternehmensspezifischen Werten, die nach innen und außen sichtbar werden müssen.

III. Prinzipien für eine ethische Fundierung von Managementvergütungssystemen

1. Rolle und Aufgaben der Kreditwirtschaft in Wirtschaft und Gesellschaft
Kreditinstitute erbringen umfassende Dienstleistungen auf den Gebieten des Zahlungsverkehrs und der Kreditversorgung für private Kunden und Firmenkunden, den Staat und staatliche Institutionen:
- Für die Realwirtschaft stellen sie den Zahlungsverkehr sowie die Versorgung mit Liquidität und Krediten sicher, unterstützen sie im Risikomanagement, bei der Platzierung von Eigen- und Fremdkapital auf Kapitalmärkten und erbringen die für das erfolgreiche Agieren auf internationalen Produkt- und Dienstleistungsmärkten notwendigen Hilfsfunktionen. Damit tragen sie zur Wertschöpfung ihrer Kunden bei.
- Für private Kunden ermöglichen sie u.a. Vermögensaufbau, Altersvorsorge und Unternehmensgründungen.

2. Nachhaltigkeit und Angemessenheit

2.1. Verlässliche Rahmenordnung
- Kreditinstitute sind auf eine verlässliche Rahmenordnung angewiesen. Entsprechend handeln sie im Regelungsrahmen, der ihnen von staatlicher, supranationaler und internationaler Seite vorgegeben ist und vermeiden Regulierungsarbitrage, die zu Nachteilen für andere führt.

2.2. Werteorientierung
- Entscheidend für den Aufbau und Erhalt von Vertrauen ist neben messbaren Fakten und Kennziffern das Offenlegen der Werte, anhand derer im Unternehmen Entscheidungen gefällt und umgesetzt werden. Mitarbeiter, Kunden, die Öffentlichkeit und die Politik müssen erkennen können, an welchen Werten sich das Handeln von Führungskräften orientiert und wie diese Werteorientierung in Entscheidungen und Handlungen zum Tragen kommt. Anderenfalls besteht die Gefahr eines
Vertrauensverlustes. Entsprechend sind Kunden- und Mitarbeiterzufriedenheit für die Bemessung variabler Einkommensteile in Betracht zu ziehen.
- Angesichts dieser grundlegenden Bedeutung für den nachhaltigen Unternehmenserfolg müssen werteorientierte Leistungsbewertungen Eingang in die unternehmensspezifischen Strategien, erträge und/oder Zielvereinbarungen finden.
- Werteorientierte Führung bedeutet, die faktischen Anreize des eigenen Managementvergütungssystems kritisch daraufhin zu prüfen, ob sie wertekonformes Handeln als Voraussetzung von Vertrauen fördern oder behindern.

2.3. Nachhaltigkeit, Leistungsgerechtigkeit und Selbstbeschränkung der Vergütung
- Nachhaltiges Wirtschaften bedeutet für Kreditinstitute, nicht allein auf kurzfristige Gewinne, sondern vielmehr auf die langfristigen Bedingungen für dauerhaft erfolgreiches Wirtschaften zu setzen. Darunter fällt insbesondere auch der Faktor Vertrauen.
- Jede Vergütung muss grundsätzlich nachvollziehbar einer entsprechenden Leistung gegenüber stehen.
- Die Institute sollen ein angemessenes Verhältnis zwischen Gesamtvergütung, Altersversorgung und ähnlichen Nebenleistungen festlegen.

2.4. Berücksichtigen von Sondereffekten
- Bei ertragsorientierten variablen Zahlungen sind marktgetriebene Erträge, die nicht der spezifischen Managementleistung zuzuschreiben sind, angemessen zu berücksichtigen. Dies schließt eine ausschließliche Orientierung der variablen Vergütung an starren Kennziffersystemen aus.
- Erfolgreiches – im Verhältnis zu Wettbewerbern besseres – Gegensteuern in Krisen soll sich in der variablen Vergütung niederschlagen.
- Zwingen Krisen zu Einschnitten bei Vergütungen der Mitarbeiter, zu Kurzarbeit oder zu Personalabbau, soll dies, wie auch in der Ausgestaltung der Maßnahmen, in der variablen Vergütung des Managements angemessen berücksichtigt werden.

2.5. Vermeiden von Fehlanreizen
- Managementvergütungssysteme müssen Anreizen zum Eingehen unverhältnismäßiger Risiken insbesondere dadurch entgegenwirken, dass die variable Vergütung sich nicht allein an der Eigenkapitalrendite orientiert.

3. Dialogfähigkeit
- Führungsverantwortung in Unternehmen heißt heute, sich über den unmittelbaren Unternehmensfokus hinaus in gesellschaftliche Diskurse einzubringen. Denn die großen gesellschaftlichen Herausforderungen werden sich nur gemeinsam, d.h. im Zusammenspiel von Politik, Wirtschaft und zivilgesellschaftlichen Organisationen, lösen lassen. Entsprechend besteht auch eine äußere Erwartungshaltung gegenüber Unternehmen und ihren Entscheidern, sich konstruktiv zu beteiligen.
- Ein wesentliches Merkmal verantwortlicher Führung ist daher die Bereitschaft und Fähigkeit, Entscheidungen im Lichte von Werten und Fakten zu reflektieren, zu treffen und gegenüber anderen zu begründen. Dialogfähigkeit meint insbesondere, sich mit den externen Erwartungen auseinanderzusetzen und auch dann Stellung zu nehmen, wenn jene Erwartungen mitunter überzogen sind.

4. Umsetzung einer ethischen Fundierung der Managementvergütung


**Unternehmen:**
*Commerzbank AG Deutsche Bank AG,*  
*DZ Bank AG HSBC Trinkaus & Burkhardt AG,*  
*HypoVereinsbank*
Banking on the Common Good, Finance for the Common Good  
Rome, 12th-14th of May 2013  

Statement by Steven Vanackere

Panel C: “Global financial governance – serving the Common Good”
I am very grateful for the opportunity to take the floor, but I cannot do this without a certain feeling of sadness, seeing that – by the time you will have heard all the panelists of today – you will have listened to 21 men and only 1 woman. Looking at the bigger picture, searching for sustainable solutions and establishing new ways for cooperation, ... these are all qualities that I associate with ‘feminine thinking’ and so it would have been good to hear more female voices in the panels.

I would like to develop 7 thoughts, inspired by a ‘critically positive’ reading of the document “Towards reforming the international financial and monetary systems in the context of global public authority” (Vatican City, presented in October 2011)

1. Let us avoid the mistake of rushing towards an artificial (and all too absolute) distinction between the mechanics of the so-called real economy versus those of the financial world. Professor Peru Sasia already warned us for such an intellectual segmentation a few minutes ago. I am not saying that the specificity of the financial crisis should not inspire us to develop specific remedies, but not if it is to entertain an illusion. The illusion that real economy is a balanced and fair process, only corrupted by the exaggeration of financial excesses. It is too easy to just put Finance on the guilty bench, forgetting that – if there is a trial to be had – it is the whole of the economy that should be implicated. Examples?

- The capitalistic model fails to create market prices (“just prices”, as discussed by Pierre de Lauzun) that integrate the societal cost of externalities (like pollution, loss of biodiversity, resources getting exhausted, ...). That is a problem of “real economy”.
- Worldwide, there is a tremendous asymmetry in the sharing of the economic value chain. One illustration: the strongest European country exports about twice as much coffee as all African countries combined (3.6 billion $ versus 2 billion $). That is a problem of “real economy” as well.
- Abuse of economic power through monopolies or oligopolies, the injustice and violence that go hand in hand with the current ‘resources grab’ on this planet, even food speculation, ... All these plagues are also problems of “real economy”.

2. This being said, it is clear that the devastating force of the recent financial crisis has shaken the world. We have learnt the hard way that financial stability is an asset subjected to the “tragedy of the Commons” 1. The “tragedy of the Commons” is a concept first described almost half a century ago, in 1968, by biologist Garrett Hardin (The tragedy of the Commons, in Science Magazine, 1968). In fact, today most of the ‘Commons’ seem to be global. Think of worldwide health through the fight against pandemics. Think of ecological sustainability. Think of peace and security. Think of financial stability...
The tragedy is that not one single actor, not one country is willing to make the sacrifices or to limit its behavior for the sake of the common global good. The economic game theory explains how countries get caught up in a prisoner’s dilemma, based on a seemingly rational expectation process concerning the behavior of the other ‘partners in the game’. A lot has to do with symmetry, but I will come back to that.

3. As pointed out in the document of the Pontifical Council, the answer is not to cut back on globalization. Protectionism and newly found (or perhaps never abandoned) mercantilism inevitably hurts progress for the poorest. Regulatory competition between nation-states, as described in the comments of Michel Prada, is absolutely counterproductive. Worldwide connectivity might be intimidating as previously local problems have today grown into global challenges of an Olympic size. Yet, the idea of retrenching behind national borders is not only an illusion at this point in history, it would also be contrary to humankind’s vocation of realizing true universality. To give just one example: access to credit and investment can be an engine of growth, lifting millions out of poverty in the developing world. Segmentation of the financial markets is not the way to achieve this. Like Barack Obama said in a speech to the General assembly of the UN: “No country is big enough to solve today’s problems on its own, no country is that small that is not part of the solution.”

4. In his book Divided Nations - Why global governance is failing, and what we can do about it, Oxford professor Ian Goldin mentions the global postal system and international air traffic control as examples showing that cooperation is possible when countries have a vested interest (e.g. countries refusing to cooperate can be boycotted by international airlines). However, new challenges of the hyper-connected Age (finance, pandemics, cybersecurity, migration, climate change) are different in their degree of complexity in securing a solution. Moreover, the interests of key countries are more than often quite varied. We need swift and fluid cooperation, adaptable to changing circumstances. Not to mention the overwhelming importance of information sharing. The traditional international treaty system is poorly suited to provide this flexibility. And we all know the diagnose that is made concerning the political architecture of the Bretton Woods institutions, still reflecting pretty much the international balance of power of 60 years ago.

I would like to submit the following idea: shouldn’t we seize the occasion of the necessary reforms (essentially as regards voting power) in these institutions to enhance cooperation? Should the influence of countries be merely proportional to their size or economic weight? Or can this influence be made proportional to their willingness to cooperate in a global environment as well? European Union member countries are following an interesting hybrid path, combining intergovernmental cooperation and EU-integration. Several undertakings, like the creation of a banking union, assuring stricter coherence in economic and fiscal policy, the gradual improvement in the fight against tax evasion, … stand to prove that there is no such thing as a “one size fits all”-solution. We will certainly discuss this further in the parallel working groups.

5. Based on my political experience, I think it is wise to keep focusing on world governance, rather than to speak of a world government. It is probably a politician’s role to remind us that in politics, perfection is often the enemy of the good. Dreaming about a world government is valuable, but in the meantime, let us recognize that (in the words of Goldin) the death knell of the nation state has been sounded prematurely.
The authors of the Pontifical Council’s document seem aware of this: they insist on the need for *subsidiarity* and on a *gradual setting up* of the ‘general authority equipped with world-wide power’ (John XXIII, *Pacem in Terris*, nr. 138, 1963). Solving free-rider problems is about international agreement, through which signatory States effectively bind themselves.

Further progress in terms of *accountability* together with a *stronger enforcement* of freely accepted commitments is in my view the most realistic way forward. Our planet needs a kind of “*transactional sovereignty*”, or “contractualization of sovereignties” if you wish. The existing transnational model of adjudication might be the embryo of a higher authority *super partes*. Rather than establishing the rules, it would need to guarantee that commitments resulting from legitimate horizontal decision procedures, be not engaged in lightly and be *sanctioned in case of non-compliance* or disrespect of the rules.

6. Before coming to my final point, in which I will speak about some of the paradoxes of the Gospel, I would like to attract your attention on an observation in a remarkable *IMF* working paper. It shows that paradoxes (*apparent* contradictions) are by no means only to be found in the Gospel. Indeed, in "*Inequality, Leverage and Crises*" (2010), senior researcher Michael Kumhof argues that it is precisely *rising income inequality* within economies that *led to the recent financial crisis*, as it was also the case also in the days of the Great Depression.

7. Let me now come to my final remark. In *Caritas in Veritate*, it is rightfully pointed out that the *roots of crises* are not only economic and financial, but *above all moral in nature*. 

As a former Finance minister, I can testify that the concept of “*moral hazard*” is one of the most frequently used in discussions in the European Ecofin Council. Especially when inspired by Matthew 19 (you will all remember the frightening comparison of the camel trying to go through the eye of a needle), one might think that “moral hazard” is defined as the risk that the behavior of the strongest and richest towards the weakest and poorest is not up to the highest moral standards. But in fact, when politicians speak about “moral hazard”, it is about making sure that nobody takes advantage of you! It is designed to guarantee that one’s solidarity is sufficiently anchored in the old Roman saying “*Do ut des*: I give in order for you to give (back).”

Reciprocity is indeed an important principle, but the genius of *true Christian solidarity* is that is does not count on reciprocity: “I give because you, as a human being, need it. Because you are worth it”. It is a matter of fraternity and “fair exchange” in the words of Cardinal Peter Turkson, that is quite remote from traditional commercial thinking. It is a matter of “de-economizing or human relationships”.

**Putting reciprocity between brackets** is not something that will be achieved by markets. It can be achieved by civil society, by cooperative initiatives and... by politics. Only then is it conceivable that the workers of the eleventh hour (5 P.M.) are paid the same as those who started working early in the morning.
Matthew 20:16. “So the last will be first, and the first will be last.”

Further progress in terms of **accountability** together with a **stronger enforcement** of freely accepted commitments is in my view the most realistic way forward. Our planet needs a kind of “**transactional sovereignty**”, or “contractualization of sovereignties” if you wish. The existing transnational model of adjudication by arbitration might be the embryo of a higher authority **super partes**. Rather than establishing the rules, it would need to guarantee that commitments resulting from legitimate horizontal decision procedures, be not engaged in lightly and be sanctioned in case of **non-compliance** or disrespect of the rules.

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**Seminar on the Global Common Good**

The Pontifical Council for Justice and Peace is grateful to the undersigned experts and academics who gathered at the Pontifical Academy of Sciences on July 11-12 to discuss the urgent questions of a more inclusive economy and governance for the common good. Pope Paul VI challenged his fellow Church-leaders to enter into “dialogue with other Christian brethren and all people of goodwill, to discern the options and commitments which are called for in order to bring about the social, political and economic changes seen in many cases to be urgently needed” (Octogesima Adveniens § 4). This is exactly what we undertook to do throughout the weekend’s sessions.

More specifically, according to Pope Francis, we cannot understand the Good News of Jesus Christ – the gospel of dignity and fraternity, of justice and peace – without being aware of real poverty, i.e., by turning our backs on the scandal of exclusion or blindly hoping that it will take care of itself (cf. Evangelii Gaudium, § 54). Quite on the contrary, it will be by putting the human being back into the heart of economics and politics, by welcoming the participation of the poor, that poverty can be overcome and the planet safeguarded.

As a fruit of the discussions, we participants, joined by others who wish to add their names, are pleased to put forward the following final statement of concern and engagement:

**Beyond the Globalization of Indifference: Towards a More Inclusive Economy**

In the face of the many unresolved issues brought to the fore by the financial crisis and our ongoing inability to bring an end to endemic poverty and exclusion, there is substantial agreement between us that, as a human community, we must recover our moral compass and re-examine the assumptions of our economic theory to be more realistic and based on a more complete view of the human being and of the world.

People welcome the job creation, healthcare improvements and the many other benefits that today’s economy has provided. Globalisation in a positive sense has the potential to bring people together. Nevertheless, many people experience a severe loss of value and morals in political and economic life, and furthermore, the means and instruments of our economy, such as money, are accorded more importance than the proper end or goal of that same economy, that is, sustaining a good life for the human community. Similarly, human beings are frequently treated as means to an economic end, and not as the reason why economic activity take place at all. The experience of social businesses demonstrates that people can be active in creating their own work and enterprises and so make a secure future for themselves. We must put people and their wellbeing at the centre of our economic and political life.

An economic system is like a natural environment. It requires diversity to strengthen its resilience. We therefore acknowledge the contribution of various actors to the economy, and in particular women and rural workers, and support the ongoing development of the many different organizational forms (for profit corporations, cooperatives, productive not for profit entities, ethical or sustainable banks and businesses, social business, and so on). They contribute to the production of social capital, as well as economic value, as an expression of economic democracy and for the fulfilment of the human being. Inadequate regulation must not be allowed to harm this biodiversity.

On the basis of this shared vision of the human person and the central elements on which our
economic thought must be founded, we share a consensus that welcomes existing reforms of the global economy, and the financial system in particular, but also that this must go much further. It is equally important to emphasize that no structural reform leading to greater inclusion can be ultimately successful unless there is a conversion of the human heart. Without a recovery of the virtue of gratuitousness and the willingness to make moral judgments, allowing our action to be guided by them, no structural reform can be sure to bring about positive outcomes.

With these premises in view, we strongly endorse and we commit ourselves to supporting the following reforms aimed at achieving a more inclusive economy:

1. The adoption of ambitious and inclusive Sustainable Development Goals centred on human dignity and a new global climate agreement in 2015 which, apart from their importance in themselves, are also critical opportunities for making a breakthrough to more effective global institutions. By doing so, we have a chance to eradicate poverty, support worker protection, environmental standards, tax revenues, and financial regulation, and confront inequality.

2. The multilateral work led by the OECD/G20 on the Automatic Exchange of Tax Information and Base Erosion and Profit Shifting (BEPS), and in confronting the “too big to fail” problem in the international banking system. At the same time, we call on the G20 to be more ambitious and explicit about the ethical framework that informs its deliberations, helping to enhance its legitimacy.

3. The fostering of financial education, financial inclusion and financial consumer protection, equipping the most vulnerable groups so that they may access finance more easily, efficiently use financial services, make informed financial choices and be protected against the effects of unfair practices. We support the creation of banks for the poor.

4. The fight against persistent structural unemployment, growing youth unemployment and the lack of security and protection for informal and rural workers are worldwide scourges. We urge policy-makers to take strong actions in order to promote access to decent and quality jobs to all segments of the societies, to promote access to education for skills, both of which are essential to human life and dignity.

5. The various initiatives of the UN and civil society to combat, in particular, child labour, discrimination against women, human trafficking, international crime, corruption and money laundering. Finally, we believe, based on the transformations which are already taking place under our very eyes, that the active participation of citizens in their economic actions and of corporations along the lines of social and environmental responsibility is crucial to tilt the balance towards the good, and that rules should be created to stimulate the development of civic and corporate virtues.

In conclusion, the Holy Father exhorted us to resist a throw-away or discarding culture: “If the human person is not at the centre, then something else gets put there, which the human being then has to serve.”

_Vatican City, 12 July 2014_
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66. Prof. Stefano ZAMAGNI
67. Rev. Dr. Augusto ZAMPINI
An ethical and regulatory Charter for Financial Markets

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1. Bankers’ oath

We take the initiative to implement by law the bankers’ oath for all employees of financial institutions. The banking industry has to demonstrate internally as well as to the public, that they are bound to a code of good conduct, ethical standards and careful practice.

Breaching of the oath must have disciplinary and criminal consequences. The Code of good conduct must be applicable to all persons performing work for the bank.

The oath formula could be:
I swear within the limits of my role that I perform at any moment in this financial institution:
• That I will perform my duties with integrity and care
• That I will carefully consider all the interests involved in my company, i.e. those of the clients, the shareholders, the employees and the society in which the company operates
• That in this consideration, I will give paramount importance to the client’s interests
• That I will comply with the laws, regulations and codes of conduct applicable to me
• That I will observe confidentiality in respect of matters entrusted to me
• That I will not abuse my knowledge
• That I will act in an open and assessable manner
• that I know and respect my responsibility towards the society
• that I will endeavor to maintain and promote confidence in the financial sector

This I declare and promise (so help me god)

This oath is taken in the above form on (date) at (place) before (name of administer and management) in the presence of (disciplinary authority)
2. **Business Culture**

Companies should encourage fairness and honest behaviour - thus creating credibility - by changing the norms and the rewards associated with the employees' professional identity:

a) The employees should take a professional oath as described above, analogous to the Hippocratic oath, lawyers or auditors professional obligation to confidentiality.

b) This should be supported by ethics training to reflect the impact of their behaviour on society rather than focussing on their own short-term benefits.

c) A norm change also requires that companies remove financial incentives that reward employees for dishonest behaviours, i.e. reckless risk taking.

d) Ethic reminders as „red flags“ may promote compliance with the honesty norm. The use of ethics reminders requires a detailed analysis of work routines to find out where and when employees make critical decisions regarding norm obedience, so that normative demands can be rendered salient at the right time and place.

e) Top management and leading decision makers have to be role models. Payments have to be transparent in goals and performance. To set up rules of transparency is the duty of the owners and their control boards.

3. **Regulatory framework**

The global financial crises of 2008 has caused enormous fiscal costs to save the banks and has shown an unhealthy dependence of banks with national budgets and debts.

Ultimately, the taxpayer has to settle the bill.

Such a systemic crises needs to be avoided in the future. The main reasons for the crash of 2008 were government-backed agencies and bond dealers that were looking for ways to maximize profits and minimize risk for themselves while heaping the risk on vulnerable small borrowers.

The Euro-zone crisis was mainly triggered by extreme rigidity and non-liberalism of some European societies, economies and political systems and financial institutions, that were betting against it. It has lead to the tragedy of extreme austerity and massive youth unemployment. As long as our Euro-political system refuses to tackle gerontocratic career structures, bureaucracies and restictive practices, all the liquidity that is printed and flushed into the financial markets by the ECB, by government debt and bank's liquidity creation will not create new asset values, new start-up's and sustainable growth.
4. **What needs to be done to improve the regulatory framework?**

- Global overliquidity is not carefully reflecting the values of real assets, this needs to be stopped!
- Member States Governments need to restructure their economies and regulate financial markets again
- The mutual dependance of debt financing states and government bonds buying bank’s has to be finished
- There has to be an insolvency rule for “too-big-to-fail” and system relevant banks
- More equity into the balance sheets of financial institutions
- Government bonds are to be weighted according to their true risk
- Control of Financial Institution’s should be established outside the ECB
- Finally and consequently it is necessary to reinforce the basic legal rule “pacta sund servanda”: Member States Governments in Europe are breaking this rule everyday because of “political reasons of survival”.
- In order to effectively reinforce this rule, it is ultimately necessary to have European Constitution as a framework for all institutions and players in the European markets.
- This Constitution should be based on the principle of subsidiarity on 5 levels: Individual, Community, Region, Member State, European Government.
- It should install full democratic parlamentary control of all european government institutions and insure direct voting and independent courts, control of competition and independent Central Bank activities.

5. **Conclusion**

The rules of the game have to be adjusted and reinforced:

- We want to reinstall again the principle of responsibility.
- Ethical behavior is compulsory for all financial players and institutions!
- Full responsibility of all actors and financial institutions for their behavior is the main principle, insolvency rules must apply.
- The financial actors and institutions have to act fair and according to ethical standards.
- The regulatory authorities have to be firm and unbiased to guarantee free and fair competitive market conditions.
- For those unable to solve their problems after insolvency, social responsibility will help – as a last resort: they will receive the solidarity of all.
Combining Purpose With Purpose
Julian Birkinshaw, Nicolai J. Foss and Siegwart Lindenberg

A sense of purpose that transcends making money can motivate employees. But to sustain both a sense of purpose and a solid level of profitability over time, companies need to pay attention to several fundamental organizing principles.

It's an old idea: If you want to build a company that truly motivates its employees, it has to have a sense of purpose. Purpose, according to Ratan Tata, the recently retired CEO of the Tata Group, is “a spiritual and moral call to action; it is what a person or company stands for.” When such a purpose exists, it provides employees with a clear sense of direction, helps them prioritize and inspires them to go the extra mile — which, the argument goes, should ultimately be good for profit.

Purpose, by its nature, transcends making money: It is about people coming together to do something they believe in and allowing profit to follow as a consequence, rather than as an end in itself. But there is a paradox here. It is hard to fulfill a purpose in the absence of money, so purpose-driven organizations either must rely on donations or benefactors to sustain themselves (as most charities and aid organizations do), or they must become self-funding through their own profits.

Is it possible for a company to strive for a higher purpose while also delivering solid profits? Some have argued that pursuing goals other than making money means, by definition, spending on things that aren’t profit-maximizing. Others have countered that by investing in worthwhile causes, the company is doing something intrinsically valuable that will generate a long-term payoff to all parties.

But, ultimately, this is a well-rehearsed and tired debate, with plenty of evidence available to support both sides of the argument. The important question is not whether there is some tension between purpose and profits; there is. Instead, the question to ask is: How can the tension between purpose and profits best be managed? What structures does a company need to put in place to ensure that its higher-order purpose isn’t squeezed out by short-term profit seeking? How can executives ensure that employees keep these dual goals in mind on a day-to-day basis? And how can this balance be achieved on a long-term basis?

This article is based on research that we have conducted over the last five years looking at the organizational challenges involved in managing two different objectives at the same time. (See “About the Research.”) We have discovered that there are a few fundamental organizing principles that help a company sustain its sense of purpose over time while still achieving a solid level of profitability. These principles, in turn, are built on a perspective known as goal-framing theory. Goal-framing theory provides a deep understanding of why pursuing what we call “pro-social” goals — which we define as goals that involve working toward common causes that go beyond just making money and staying in business — creates a stronger motivational basis for working in organizations than pursuing self-interest goals that emphasize financial gain or personal enjoyment.

The article is structured as follows: We provide a brief overview of goal-framing theory, then describe three companies that have sustained a balance over time between purpose and profits. Based on this combination of theory and evidence, we then describe some practical ways of applying these insights inside your own company.
About The Research

This article draws on a five-year program of research we conducted to understand how companies put in place innovative ways of managing conflicting strategic imperatives, or “dualities,” such as purpose versus profitability, alignment versus adaptability, global versus local and exploitation versus exploration. This research was conducted under the auspices of the Management Lab at London Business School and the Department of Strategic Management and Globalization at Copenhagen Business School. We conducted more than 80 in-person interviews with executives from 15 companies, listed below. Some of these case studies were written up in academic publications and books, while others were used as teaching materials. In addition, we conducted experimental and theoretical research into goal framing, the main psychological theory behind the ideas in the article. The companies whose executives we interviewed for this research were: Guardian News & Media, HCL Technologies, IKEA, Irdeto, John Lewis Partnership, LEGO Group, NRMA, Novo Nordisk, Roche, Rio Tinto, Seventh Generation, Svenska Handelsbanken, Tata Group, Whole Foods Market and W.L. Gore & Associates. (See the endnotes for references to this work.)

How Company Goals Influence Employee Behavior

Understanding how a company’s goals influence its performance requires understanding what motivates employees’ behavior on a day-to-day basis. That individuals are motivated to do their own work well is important, but a company with a higher-order purpose is typically asking them to also take a broader view and influence their joint effort toward common goals. Collaborative effort of this type involves a lot more than just doing a task well; it also takes understanding of and commitment to the common goal, and it takes the flexibility to use one’s wits, especially when new situations arise. For this kind of work, employees must be motivated in a special way.

There are numerous, partly overlapping views on what drives motivation in companies. However, most have little to say about the links between company goals and individual motivations, that is, what motivates employees to behave in ways that help—or don’t help—the company or group to which they belong. A less well-known but highly relevant view that speaks directly to these issues is goal-framing theory.

Goal-framing theory starts from the idea that, at any moment, people have a major area of concern that makes them focus on specific aspects of their work and neglect others. When employees are concerned about feeling good, they will look out for the fun parts of their job, for the one activity in their job that really excites them, and they will neglect things that feel boring or a bit uncertain. This is called a hedonic goal. When the major concern is income and/or promotion, an employee will focus on opportunities to earn extra money or make a good impression that helps raise the odds of getting promoted and will neglect other aspects of the job. This is called a gain goal. And when the major concern is to realize a common goal, such as getting a product launched on a tight timeline or delivering on a fundraising campaign, employees will attend mainly to that goal and will downplay concerns for relaxation, making more money or getting a better position. This is called a pro-social goal.

What factors influence the relative strength of these three types of goals? Obviously, innate differences between individuals plays a part, but a much stronger influence is typically the immediate stimuli employees receive from those around them in their working environment and from their superiors. If all the talk is about the size of the annual bonus, the gain goal will immediately dominate others. But many companies want their employees to help the organization realize common goals,
rather than to prioritize personal gain or fun on the job. So the challenge becomes how to make such common goals more salient and meaningful to employees across the company. To a large extent, this is a matter of trying to convey the purpose of the company to employees so they can see how their efforts fit with those of other employees to fulfill its overall purpose. This works best if the purpose is pro-social, because that provides a very direct link from the company goals to a pro-social orientation of the employees.6

Unfortunately, and this is a key point, the motivation to pursue pro-social goals is inherently fragile. It takes a great deal of effort to establish and maintain such goals, and they are easily displaced by gain or hedonic goals.7 There is no simple solution, because gain and hedonic goals cannot be abandoned entirely. Working toward company goals without being rewarded and without feeling good is not a stable long-term proposition. So there is a delicate balance needed here, and goal-framing theory provides some valuable insights into how it might be maintained.8

As a first guideline, the company’s statements should prioritize pro-social goals ahead of financial goals. For example, if a medical-products company is seeking to “put patients first,” then this goal should be center stage in all external and internal communications. Financial goals, in contrast, should be approached in an oblique or indirect way; they should be seen as the natural consequence of achieving the pro-social goals, rather than as ends in themselves. If financial goals are given too much prominence, they will typically displace the pro-social goals.9

Second, the fragility of pro-social goals means that they need reinforcing and supporting on a consistent and regular basis through incentive and reward systems, through informal conversations and discussions, through symbolic management and through formal structures that we call counterweights.10 For example, individual rewards should be linked to the performance of the group, operating unit or company as a whole, rather than just to individual outcomes. And managers should seek to acknowledge and highlight behaviors that support the pro-social goals of the company by, for example, building them into annual reviews and publicly celebrating and rewarding employees who successfully strive to meet the company’s pro-social goals.11 Without such reinforcement, employees will see a disconnect between the demands of their immediate job and the espoused goals of the company, and the pro-social goals will end up being displaced in favor of gain or hedonic goals.

Enduring Pro-Social Management Models

Goal-framing theory provides a useful new way of looking at the challenges companies face in aligning behavior around goals. Our research found many companies with a clear sense of purpose, typically expressed as a set of pro-social goals such as putting employees first or investing in local communities. But, in the majority of cases, there was no discernible impact on the way employees actually behaved. Sometimes the pro-social goal was just a set of words — in effect, a veneer on top of a gain-driven company.12 Sometimes the pro-social goal had been genuine at some point in the company’s history, but over time, its meaning atrophied as other goals became more salient. However, we also found a small number of highly successful companies whose pro-social goals seemed genuine. (See “About the Research” for a list of the 15 companies interviewed.) In talking to employees at multiple levels and in looking at the way they behaved and the things they valued, we could see evidence that these companies’ pro-social goals were influencing employee motivation and behavior. We focus on three cases here.

Handelsbanken

In the crisis-ridden banking industry, Svenska Handelsbanken, established in Stockholm in 1871, stands out as an extraordinarily resilient and successful operation. Unlike a number of its
competitors, Handelsbanken steered a course through the Swedish financial crisis in the early 1990s without government help, and it has sailed through the last five years of turbulence with uninterrupted growth in equity per share and with top ratings for customer satisfaction.

How has Handelsbanken been so consistently successful? Its pro-social goal is not very original: It is simply to be customer-focused. As the company declares on its website: “Since the early 1970s, Handelsbanken’s organization has been strongly decentralized and operations are always based on the customer’s requirements. This means that all business decisions regarding individual customers’ relationships with the Bank are taken close to the customer.”

But rather than just talk about customer focus, Handelsbanken has built a management model that supports its goals. First, the bank’s structure is highly decentralized. Managers of individual branches have much more discretion regarding loans and employee salaries than is customary in the industry. This reduces the cost of information transfer and supports rapid responsiveness to changing market conditions. The company was also a pioneer of the “beyond-budgeting” movement: It has moved away from setting budgets on a top-down basis, and instead it expects branch managers to set their own targets.

There is no emphasis on maximizing returns or shareholder returns; the goals are simply to track a moving target by always having higher customer satisfaction and profitability than a weighted average of the competition. These goals are then linked to a combined profit-sharing and employee stock ownership scheme called Oktogonen. Profits are shared equally across the organization (rather than on an individual basis), and when the bank’s after-tax return on equity is higher than the industry average, shares are issued to all employees. This model has been employed since the 1970s, so that today employees own more than 40% of the total equity, and many long-term employees have become millionaires. The equal profit-sharing scheme is an excellent example of how financial rewards can strengthen a pro-social goal rather than displace it.

**Tata Group**

One of India’s biggest conglomerates, Tata Group had revenues of more than $90 billion in 2012, spread over such sectors as IT services, steel, cars, chemicals and hotels. The group was founded in 1868 by Jamsetji Tata, and it has always been strongly influenced by the Tata family. Family-founded trusts hold 66% of the equity capital of Tata Sons, a holding company. Below that sit various Tata operating companies, some wholly owned by Tata Sons, others public companies where Tata Sons has a minority stake.

Tata’s pro-social goal is “to improve the quality of life for the communities we serve.” As stated on the corporate website, “the community is not just another stakeholder in business, but is in fact the very purpose of its existence.” As with Handelsbanken, this is not a highly original statement of purpose, but it is backed up with supporting mechanisms that ensure it is taken seriously. The charitable trusts that own 66% of Tata Sons spend their profits on charitable causes such as clean water delivery, literacy and health care. The Tata operating companies are then expected to put significant investments into the local communities they serve. For fiscal 2009, the total social expenditure across the group was estimated at $159 million.

The Tata Group wields influence over the operating companies in a number of informal ways. Group functions provide training and education and quality management services, and Tata Sons’ executives sit on the boards of the operating companies. The Tata Group is also highly visible in its commitment to community development in, for example, its launch of the Nano car and the low-cost Swach water purifier.

**HCL Technologies**

HCL Technologies, with headquarters in Noida, India, was a second-tier player in the highly competitive IT services sector when Vineet Nayar became president in 2005. Nayar, who became CEO in 2007, decided to differentiate HCL through the quality of its management — by putting his employees first and by enabling them to create value in their relationships with customers. He embarked on a major transformation program, first pushing everyone to accept that the company
was underperforming and needed to change and then putting in place a series of specific initiatives that were designed to help employees service their clients better. For example, he pushed all managers to place the results of their 360-degree appraisals online to make them more accountable to their employees; he also created a “service ticket” scheme, so that if an employee wasn’t happy about something he could open a ticket to get the attention of the relevant manager. Nayar tracked the number of tickets opened, and the speed with which they were closed, as an indicator of employee well-being.

As these initiatives began to take hold, Nayar captured his philosophy with the slogan “employees first, customers second,” which he announced — with some trepidation — at the annual global customer meeting. Further initiatives were added, such as the Employee Passion Indicator Count (EPIC) survey, which was used to identify the key “passions” of employees and to steer them towards jobs where these could be put to use.

By 2012, HCL had recorded an industry-leading compound annual growth rate of 24%. In our discussions with HCL employees, it was clear that many (though admittedly not all) had bought into Nayar’s “employees first” model and saw the company as a highly attractive employer. Turnover rates were lower than in competitor companies, and the highest ratings on the EPIC survey were around collaboration and client service. (Nayar stepped down from his role as CEO in 2013.)

**Making Pro-Social Goals Pay**

So what are the insights from these three brief case studies? The basic premise is that what motivates employees consistently to realize company goals also makes economic sense. The companies discussed are in very different industries, and the length of time they have been pursuing their pro-social goals varies enormously. But nonetheless there are some underlying principles here, and from goal-framing theory more generally, that can be applied in many other settings.

**Pro-social goals don’t have to be elaborate or novel.** The first point is that there are only a limited number of pro-social goals that a company can meaningfully target. For Handelsbanken, it is all about the customer; for Tata, it is about the communities in which the company operates; and for HCL, the pro-social goal is employee well-being. Other common pro-social goals involve a focus on employee safety (mining company Rio Tinto) or the natural environment (consumer products company Seventh Generation). We did not find evidence that companies thrived because they dreamt up a highly unique pro-social goal that nobody else had thought of. Rather, the evidence suggests the successful companies are the ones that were able to translate pedestrian-sounding pro-social goals into consistent and committed action.

**Pro-social goals need supporting systems if they are to stick.** We know that people take cues from those around them, but people are fickle and easily confused, and gain and hedonic goals can quickly drive out pro-social goals. So a key insight is that these three companies have built a wealth of supporting systems to help them operationalize their pro-social goals at different levels, and thereby make them stick. At Handelsbanken, the supporting systems are relatively formal: the highly decentralized branch structure, the removal of budgets and the equal profit-sharing system. At Tata, the supporting systems are more informal and are reinforced through the visible initiatives and pronouncements of the top executives. At HCL, the supporting systems were, initially, Nayar’s personal promotion of the “employees first” agenda plus a set of innovative practices designed to reinforce it. And in the first two organizations, in particular, there has been consistency in these systems over many years, which further reinforces their value. Such consistency matters because it signals that management is sincere.

**Support systems are needed to reinforce goals.** One important form of supporting system is to incorporate tangible manifestations of the company’s pro-social goals into the day-to-day work of employees. For example, IBM sends future managers to work with NGOs on development projects in
Nigeria, Ghana, Tanzania and the Philippines to put substance behind its Corporate Citizen’s Core program. We have also seen health care companies bring patients into their offices to talk about how the company’s products have helped them. The world leader in insulin production, Novo Nordisk, requires that all new employees spend a day with a diabetes patient. For employees working on the front lines of their company, such systems are unnecessary, but many back-office employees lose touch with their company’s raison d’être, so this is a good way of making it visible.

Another important supporting system is to find ways of measuring progress on pro-social goals and to report them publicly. For companies that see customer focus as their goal, the Net Promoter Score has become a popular measure; for those that seek to put their employees first, engagement scores are often used; and for those that focus on safety, lost-time injuries are typically a preferred metric. Unfortunately, there aren’t yet established measures for community or environmental pro-social goals, though some companies are experimenting with them; one example is Guardian News & Media’s annual sustainability report. Regardless of the measure used, what matters is that the information is shared in a transparent and consistent way with the relevant stakeholders. HCL’s initiative to share feedback on how well managers are doing for all employees to see is a good example.

Pro-social goals need a “counterweight” to endure. Goal-framing theory shows how easy it is for pro-social goals to be driven out by gain or hedonic goals, so even with the types of supporting systems described above, it is quite common to see executives bowing to short-term financial pressures. Thus, a key factor in creating enduring pro-social goals is a “counterweight,” by which we mean any institutional mechanism that exists to enforce a continued focus on a nonfinancial goal. For Handelsbanken, the Oktogonen profit-sharing system is the counterweight. For Tata Group, it is the family-endowed trusts. At U.K. retailer John Lewis, the counterweight is the employee council, which represents the employees as ultimate owners of the company. At the Guardian newspaper, the counterweight is the editor, who is appointed by the ultimate owner of the newspaper (the Scott Trust Limited) and is free to exercise editorial control over content, regardless of the company’s commercial priorities. The counterweight holds the power of the executive office in check and ensures that the long-term interests of the organization are not sacrificed for short-term benefits. The key is that the counterweight has real influence; it must hold the leader to account.

Alignment works in an oblique, not linear, way. In most companies, there is an implicit belief that all activities should be aligned in a linear and logical way, from a clear end point back to the starting point. The language used — from cascading goals to key performance indicators — is designed to reinforce this notion of alignment. But goal-framing theory suggests that the most successful companies are balancing multiple objectives (pro-social goals, gain goals, hedonic goals) that are not entirely compatible with one another, which makes a simple linear approach very hard to sustain. So an important mental leap to make is the notion that long-term profits are often best achieved obliquely, or indirectly. As Ratan Tata, former CEO of the Tata Group, has observed, “Profits are like happiness in that they are a byproduct of other things ... [companies] need sustainability strategies that recognize that you can make money by doing good things rather than the other way around.” In their best-selling business book Built to Last, Jim Collins and Jerry Porras argue that “visionary” companies with pro-social goals had better long-term profitability than their benchmark competitors, which typically opted for narrower financial goals.

What does this mean in practical terms? If you want your employees to align around a pro-social goal, you have to eschew narrow, linear thinking, and instead provide more scope for them to choose their own oblique pathway. This means emphasizing the pro-social part of the story on a consistent basis — the intention being that by encouraging individuals to do “good,” their collective
effort leads, seemingly as a side-effect, to better financial results. The logic of “pro-sociality first, profitability second” needs to find its way deeply into the collective psyche of the company.

For example, while Carlsberg A/S, a brewing company based in Copenhagen, Denmark, has pursued ambitious profitability and growth ambitions, the majority of its shares are owned by the Carlsberg Foundation. What’s more, the foundations associated with the brewing company have shaped Danish cultural life for more than 100 years. This subtle linking of beer and high-brow culture is very much part of the company’s identity.

Pro-social initiatives can be implemented at all levels. Who is responsible for pursuing a pro-social agenda? If you head up a division or business unit, it is clearly your job to define what your pro-social goals are and to put in place the supporting structures and systems described here. But what if you are lower in the corporate hierarchy? It is tempting to think this is “someone else’s problem,” but actually there is no reason why you cannot follow your own version of the same process. We have seen quite a few mid-level managers make a real difference, and often quite quickly, using the principles outlined here. (See “Pursuing Pro-Social Goals in an Operating Unit.”)

Pursuing Pro-Social Goals in an Operating Unit
Managers can apply goal-framing theory within their own operating units. Consider the case of Jesper Ek, a mid-level manager at Roche, the Swiss pharmaceutical company. Ek was asked by his boss in 2012 to take charge of an underperforming 20-person diabetes team in Sweden that had seen sales drop year by year since 2006. When he took on the assignment, the employee engagement score for the team was 22% and, even more disturbing, the disengagement was as high as 66%. “I realized that employees had lost their sense of purpose,” he recalled.

For the first three months, Ek focused solely on understanding the team — and team members’ fears, motivations and concerns. “I had one-on-one meetings with everyone, typically two hours each, and lots of team meetings.” By June, he felt he had the measure of his team, and he switched from an internal to an external focus. He held a workshop to discuss the group’s collective goals, and they agreed on a common purpose: “To enable for people with diabetes to live their lives as unrestricted as possible.”

This pro-social purpose created real clarity for the team, enabling them to push two particular offerings that linked to solutions for the common purpose (an integrated mobile meter and a pump system with remote control that enabled unrestricted life with diabetes) and to reduce their attention to the other 15 products in their portfolio. This focus made it possible for the team to gain access to clinics they had previously struggled to get into and, when there, for them to have more effective and purposeful meetings. Just a year later, the engagement score had risen to 75%, the disengagement was down to 0% and only two of the original 20 people had left. There were market share gains of more than 3%, an impressive 250% growth with the integrated meter and growth both in total sales and in operating profit.

“My approach,” Ek observed, “was to not think about profitability at all for the first six months. By getting my team on board, we were able to come up with a purpose that provided clarity and got everyone motivated. It helped that I had a supportive boss who gave me a clear mandate to do what I felt was necessary and then got out of the way — but it turned out that the turnaround was sufficiently quick that he didn’t have to cut me much slack.”

Despite facing many competitors with very similar products, Ek’s focus on vision and purpose helped to differentiate the business’s positioning in the marketplace. As Ek noted, quoting leadership expert Simon Sinek: “People don’t buy what you do; people buy why you do it.”

Corporate Purpose and Profitability
In a famous article in Time magazine, Robert Ajemian reported George H.W. Bush’s exasperated reaction to friendly suggestions that he invest time in carefully thinking about his prospective
presidency: “Oh, the vision thing.” 23 Many CEOs react in much the same way: They know they are supposed to have a corporate vision or purpose, but they secretly think that wordy statements about the purpose of their business are just empty rhetoric. And it doesn’t take long for employees and other observers of the company to figure this out.

The purpose of this article is to help you to understand why and how a corporate purpose matters and to show how it can be realized without sacrificing profitability — and indeed may result in higher profitability. Goal-framing theory shows that a company’s goals make a difference only when they work on the beliefs of employees, and that the most valuable goals are those that support collaborative work — what we have called pro-social goals. However, these goals compete with other goals for individual mind share and are easily driven out by gain and hedonic goals. As a result, corporate executives have to work doubly hard to affirm pro-social goals and to develop systems and structures that reinforce them. And, most fundamentally, establishing pro-social goals requires developing a tolerance for obliquity — that is, the paradoxical notion that if we follow pro-social goals we aren’t actually getting rid of gain goals. Instead, we are realizing them more effectively.

References (24)
2. We acknowledge other studies have provided useful advice to social enterprises, particularly around the notion of shared value, such as M. Pfitzer, V. Bockstette and M. Stamp, “Innovating for Shared Value,” Harvard Business Review 91, no. 9 (September 2013): 100-107. This study starts from a theoretical perspective on human motivation and as a result it offers somewhat different, though complementary, recommendations about how organizations of all types — not just social enterprises — can balance competing objectives.
5. Strictly speaking, goal-framing theory talks about normative goals that underlie employees’ motivation for joint production rather than pro-social goals. Normative goals are goals held by individuals. However, company goals with a normative orientation are often called “pro-social.” To simplify the terminology here, we use the term pro-social for both levels: Pro-social goals of companies activate pro-social (“normative”) goals in employees.
6. In a game where people would be individually better off (in terms of money) not cooperating, the experimenters saw a much higher percentage of participants cooperate when it was called “community game” compared to when it was called “Wall Street game.” Labeling the game with “community” or “Wall Street” simultaneously expressed the purpose of the game, what kind of


8. See Lindenberg and Foss, “Managing Motivation.”


10. See Lindenberg and Foss, “Managing Motivation.”


14. There is plenty of evidence that traditional budgeting processes are flawed. See, for example, M.C. Jensen, “Paying People to Lie: The Truth about the Budgeting Process,” European Financial Management 9, no. 3 (September 2003): 379-406.

15. The Tata Group case study is based on data collected through interviews with company executives as well as on A. Graham, “Too Good to Fail,” Strategy + Business 58 (spring 2010).


17. Graham, “Too Good to Fail.”


About the Authors

Julian Birkinshaw is a professor of strategy and entrepreneurship at London Business School. Nicolai J. Foss is a professor of strategy and organization at Copenhagen Business School and the Norwegian School of Economics in Bergen, Norway. Siegwart Lindenberg is a professor of cognitive sociology at the University of Groningen and Tilburg University, both in the Netherlands.
Cor van Beuningen

Organiseren van moraliteit en vertrouwen?

Dit verhaal gaat over besturen, organiseren, beleid maken, managen; over governance, in die brede zin van het woord. “Governance is the sum of many ways individuals and institutions, public and private, manage their common affairs”. Governance dus – van een land of stad, een organisatie of instelling, een bedrijf of een afdeling ervan, enzovoorts.

Startpunt is de volgende driedelige constatering:

- onze gangbare manieren van besturen en organiseren zijn uitgewerkt en genereren in de praktijk steeds meer onbedoelde en averechtse effecten;
- in de literatuur over governance van de afgelopen vijf of tien jaar wordt dat één en andermaal aangetoond en worden ook alternatieve governance stijlen voorgesteld;
- maar in de praktijk verandert er maar heel weinig.

De verklaring voor deze inertie ligt voor een deel in gevestigde belangen en starre structuren die vast zitten aan bestaande routines in organisaties en instellingen; dat wil zeggen in een ideologie (van de besturende elite) en in een (hiërarchische) architectuur. In de gangbare wijze van governance is het de top die de wijsheid heeft en de doelen en strategie uitstippelt, en het is ook de top die de hoogste status heeft en de hoogste beloning ontvangt. Hamel verbindt ideologie, architectuur en werkwijze kernachtig als volgt:

“Strategy gets set at the top. Power trickles down. Big leaders appoint little leaders. Individuals compete for promotion. Compensation correlates with rank. Tasks are assigned. Managers assess performance. Rules tightly circumscribe discretion. This is the recipe for “bureaucracy”, the 150-year old mashup of military command structures and industrial engineering that constitutes the operating system for virtually every large-scale organization on the planet.”

Vernieuwing stokt echter vooral door het feit dat het weliswaar duidelijk is dat de gangbare manieren van organiseren en sturen zijn uitgewerkt, maar dat niet precies duidelijk is waaróm dat het geval is; met als gevolg dat de voorgestelde alternatieve governance stijlen op essentiële punten tekort schieten. Wat nodig is, is een fundamentele verandering in de conceptie van het te besturen object. Daarover gaat dit verhaal.

Knave or knight?

Begin jaren ’80 van de vorige eeuw voltrok zich een omslag in de wijze waarop politiek en beleidsmakers naar zorgprofessionals en andere public servants kijken. Tot die tijd werden ze

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3 Richard Straub signaleert: “(...) a reality check shows that, despite considerable progress in making management more effective, many fundamental challenges remain. Bureaucratic hierarchies, in the form of control-oriented, top-down structures, are still highly prevalent”.
4 Gary Hamel, Bureaucracy must die (https://hbr.org/2014/11/bureaucracy-must-die/).
gerspecteerd en gewaardeerd als altruïstische dienstverleners met hoge professioneel-ethische standaarden. Maar in de jaren ‘80 veranderde deze perceptie. Allengs werden ze gezien als opportunistische en egoïstische zakkenvullers die bovendien de kantjes eraf lopen.


Julian Le Grand was enkele jaren de adviseur van premier Tony Blair en hij is ‘one of the principal architects of the UK Government’s current public service reforms introducing choice and competition into health care and education’. Hij is de bedenker van invloedrijke concepten als quasi-markt en The Other Invisible Hand, die ook bepalend zijn geweest voor de introductie van marktwerking en de transformatie van de zorg in Nederland. In een quasi-markt werken de marktmechanismen van keuzevrijheid voor de consument en concurrentie tussen de aanbieders, maar wordt de koopkracht (deels) gefinancierd door de overheid, die ook collectieve doelen formuleert en kaders stelt voor die marktwerking.

In zijn boek Motivation, Agency, and Public Policy gaat Le Grand uitgebreid in op de governance dilemma’s die verbonden zijn met de spanning tussen knighthly en knavish motieven van de public servant. Hij ziet wel degelijk in dat sturing met financiële prikkels averechts kan uitwerken en juist knavish gedrag in de hand kan werken; mensen worden erdoor aangezet om de beloning te optimaliseren met een zo gering mogelijke inspanning, terwijl de bij hen wel aanwezige bereidheid om zich in te zetten voor de goede zaak wordt afgebroken. Dit is het zogenaamde crowding-out effect: de inzet van beloningsprikkels heeft tot gevolg dat altruïstische motieven verdrongen worden door opportunistische en eigenbelang-dienende attitudes. Een bekende illustratie hiervan is dat van de bloedbank, voor het eerst beschreven door Richard Titmuss. Om het aantal donoren te verhogen introduceert een bloedbank een beloning van 25 euro. Het aantal donoren blijkt vervolgens echter af te nemen. Verklaring: voorheen altruïstisch gemotiveerde donoren gingen nu kijken naar wat ze doen in termen van geld - en dan is 25 euro maar een magere beloning. Of ook: mensen willen zoiets bijzonders als hun bloed geven wél doen als goede daad voor de medemens in nood, en niet voor geld. Titmuss confronteerde economen zo met een lastig vraagstuk, omdat hiermee de meest fundamentele wet uit de economie wordt gerelativeerd, namelijk dat een verhoging van de prijs leidt tot een verruiming van het aanbod.

Dit crowding-out effect is nadien uitgebreid empirisch onderzocht door de Zwitserse econoom Bruno Frey. Vaak wordt hij geciteerd waar het gaat om de crowding-out effecten van prijs/marktprikkels,
maar zijn onderzoek betreft “all interventions emanating from outside the person considered, i.e. both positive rewards and regulations accompanied by negative sanctions”. De kern van het effect is gelegen in de onteigening, d.w.z. het verlies van *agency* en *self-esteem*, die ervaren wordt door sturende en controlerende bemoeiën van hogerhand:

“External interventions crowd-out intrinsic motivation if the individuals affected perceive them to be controlling. In that case, both self-determination and self-esteem suffer, and the individuals react by reducing their intrinsic motivation in the activity controlled.”

*Crowding-out* treedt dus op als resultaat van sturing met geconditioneerde beloningsprikkels, via twee psychologische processen: beschadigde zelfregie (*freedom to act*) en beschadigde zelfwaardering. Een intrinsiek gemotiveerd persoon is juist bereid om een activiteit uit te voeren ook al ontvangt hij of zij daarvoor geen andere beloning dan die is gelegen in de activiteit zelf; en bij die intrinsieke motivatie spelen handelingsvrijheid en (zelf-) waardering voor toewijding, engagement en competentie dus een bepalende rol.

Le Grand erkent dat voor een goede dienstverlening zaken als toewijding en beroepstrots van de professional van fundamenteel belang zijn. Aan de andere kant kan niet ontkend worden dat mensen tot altruïstisch én tot opportunistisch gedrag in staat zijn, en dat er geen valide reden is om te veronderstellen dat *public servants* zich aan deze regel onttrekken. Het zou dus onverantwoord zijn, aldus Le Grand, om ons in blind vertrouwen uit te leveren aan de nobele motieven en eergevoelens van de professionals, omdat zij niet allemaal en altijd het beste met ons voorhebben. Le Grand s oplossing is dat het beleid het moet zoeken in ‘robuuste stimulansen’, die het opportunisme in goede banen leiden en de nobele motieven in stand houden. Hij komt er, met andere woorden, zelf ook niet uit.

De wijze waarop Le Grand het governance dilemma stelt is wel helder en overtuigend. Dit dilemma geldt niet alleen waar het gaat om de “aansturing” van *public servants* door de overheid. Het lijkt eerder een onontkoombaar dilemma voor *alle* governance, of het nu gaat om de werking van de *iron hand* van de staat of van de *invisible hand* van de markt. Het geldt evengoed voor de relatie tussen overheid en burger, tussen principaal en agent, manager en staf, werkgever en werknemer, bijstandsinstelling en bijstandstrekker, etc.

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(a) *Impaired self-determination*. When individuals perceive an external intervention to reduce their self-determination, they substitute intrinsic motivation by extrinsic control. Following Rotter (1966), the locus of control shifts from the inside to the outside of the person affected.

(b) *Impaired self-esteem*. When an intervention from outside carries the notion that the actor’s motivation is not acknowledged, his or her intrinsic motivation is effectively rejected. The person affected feels that his or her involvement and competence is not appreciated which debases its value. An intrinsically motivated person is taken away the chance to display his or her own interest and involvement in an activity when someone else offers a reward, or commands, to undertake it. As a result of impaired self-esteem, individuals reduce effort.

10 Frey, Bruno S. and Jegen, Reto: ibid, p6:

*External interventions crowd-in intrinsic motivation if the individuals concerned perceive it as supportive*. In that case, self-esteem is fostered, and individuals feel that they are given more freedom to act, thus enlarging self-determination.

11 Arie Glebbeek, *Eerherstel van de eer*, in Academische Boekengids 68, 2008,

Samengevat:

1. Een stad of een samenleving, een bedrijf, instelling of organisatie – ze kunnen alleen goed functioneren en presteren als de bestuurden zich *knighthly* gedragen, met toewijding en engagement, creatief en sociaal, medeverantwoordelijk voor the *common purpose*.

2. De bestuurder kan zulks gedrag echter niet decreteren of afdwingen. Sturing door middel van geconditioneerde beloningsprikkels (*rewards en/of sancties plus controle*) heeft eerder juist een averechts effect op de morele en sociale attitudes van de bestuurden. Bestaand moreel kapitaal wordt erdoor afgebroken en de geconditioneerde beloningsprikkels verhinderen dat nieuw moreel kapitaal wordt aangemaakt. Het stelsel zal perverteren en is ten dode opgeschreven.

3. Maar de bestuurder kan de zaak ook niet op zijn beloop laten, want dan krijgen de *knaves* onder de bestuurden vrij baan en zal *knavish* gedrag zich snel propageren; ook dan is het stelsel ten dode opgeschreven.

**Knave noch knight; de oplossing van het dilemma**

De oplossing van dit dilemma begint bij inzicht in de wijze waarop en de situaties waarin mensen hun morele en sociale kwaliteiten aanspreken en ontwikkelen. Dat doen ze inderdaad niet vanzelf. Verhelderend is in dit verband de *goal framing* theorie van Siegwart Lindenberg. Hij onderscheidt drie types van doelen waardoor mensen in hun handelen gedreven of gemotiveerd worden: hedonistische doelen; hier gaat het om plezier, de ervaring van positieve emoties als geluk, troost en het vermijden van schuld, schaamte of ongemak - *fun goals* instrumentele doelen; hier gaat het om een beloning (of voorkoming van straf), de verbetering van de persoonlijke situatie; *gain goals*, vooral sterk als de beloning direct gekoppeld is aan de handeling morele (Lindenberg noemt ze: normatieve) doelen – gericht op handelen zoals je denkt dat je moet doen, ook in het kader van een gezamenlijke inspanning, dus volgens de overtuigingen die gedeeld worden door de groep of het sociale systeem (*moral and social goals*).

*Goal framing* houdt in dat mensen steeds alle drie doelen tegelijkertijd nastreven, maar dat in een gegeven situatie er één is welke de overhand krijgt (geframed wordt) en de andere twee naar de achtergrond duwt en daardoor in die situatie aan het handelen richting geeft. Die andere twee verdwijnen daarmee niet en kunnen in op een volgend moment dominant worden, zelfs in een opvallend gelijkloudere situatie.

Mensen zijn niet *knave of knight*. Ze zijn het allebei. De ene keer *framen* zij hun handelen zodat de andere keer zo. De *framing* kan per situatie verschillen: *fun, gain of moral/social goals*. Als dat zo is, is het van belang om inzicht te krijgen in de situaties, processen en prikkels die mensen ertoe brengen om hun doelen op een bepaalde manier te *framen*. Zo ligt het voor de hand dat sturing door middel van een geconditioneerde beloningsprikkelt het effect heeft dat mensen hun handelingsdoel als een *gain goal framen*, ten koste van de andere goals – zie ook het boven genoemde bloedbank-effect. In stelsels (organisaties, bedrijven, instellingen etc.) die georganiseerd worden rond geconditioneerde beloning worden morele en sociale kwaliteiten van mensen systematisch genegeerd, niet geactiveerd en niet ontwikkeld.

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Lindenberg maakt ook duidelijk dat moreel handelen ook een sociaal aspect heeft. Mensen activeren moral/social goals en ontwikkelen hun morele en sociale kwaliteiten niet omdat/als ze daartoe gestuurd worden. Dat doen ze alleen zelf en in interactie met anderen in de omgeving; in verbanden van mensen die samen aan de slag zijn, in een gezamenlijke inspanning, vanuit gedeelde overtuigingen en met een gedeelde purpose.

Hier ligt ook de oplossing van het klassieke governance dilemma zoals dat hierboven op scherp is gezet. Dit dilemma is onontkoombaar en ook onoplosbaar vanaf het moment dat de bestuurden gezien en behandeld worden als individuele personen, vrij en autonoom, socially disembedded, los van verbanden die hen aanspreken, discipliner en socialiseren. Moraliteit en socialiteit zijn nauw verbonden. Het zijn de ogen en waarderende oordelen van leden van een betekenisvol verband die mensen ertoe aanzetten om in een gegeven situatie moral/social goals te framen. En het is in de interactie in zulke verbanden dat mensen hun morele en sociale kwaliteiten ontwikkelen en zichzelf en de ander humaniseren en tegelijkertijd maatschappelijke stelsels laten functioneren en bloeien.

Le Grand kent echter alleen maar individuen. Hij ziet niet dat het knightly gedrag van bijvoorbeeld artsen niet een persoonlijke karaktertrek is maar mede een product van een zelfregulerend, socialiserend en discipinerend verband, hier in de vorm van een beroepsgroep met een eigen scholing en beroepsethiek en collegiale controle ondersteund door tuchtrecht. Schiet dit tekort, dan ligt het voor de hand om het te versterken of aan te vullen met andere betekenisvolle verbanden, bijvoorbeeld op het niveau van de instelling of in verbanden met cliënten, buurtbewoners etc.; dat zal per situatie variëren, en soms zal het enige begeleiding kosten om ze te laten ontstaan.

Maar Le Grand kommt nicht verder dan de introductie van (quasi-) marktwerking en geconditioneerde beloningsprikkel. Het resultaat laat zich raden, te zijner tijd; maar intussen zijn de verbanden gedeactiveerd en is het erin belichaamde moreel-sociale kapitaal verloren. Navrant is wel dat één van de manieren die op dit moment wordt voorgesteld om het geschonden maatschappelijke vertrouwen te herstellen in die andere beroepsgroep, de bankiers, is: de invoering van een eigen beroepsethiek, inclusief bankierseed, scholing, collegiale controle en tuchtrecht.

Wat is het probleem: afnemende beleidseffectiviteit?

De introductie van sturing met geconditioneerde beloningsprikkel van geïndividualiseerde public servants is te zien als de zoveelste stap in een proces dat al twee eeuwen geleden begon, het begin van de moderne tijd. Besturen, organiseren, governance werd een (sturings-) relatie tussen bestuurder, enerzijds, en bestuurden gezien als autonome en rationele individuen, anderzijds. Knellende Gemeinschaftsbanden werden vervangen door de onpersoonlijke, transactionele relaties van de Gesellschaft en de rationele en efficiënte Weberiaanse bureaucratie waarvoor iedereen gelijk is. Individuen kunnen voortaan vrij kiezen, en ze zullen hun keuzes baseren op rationeel denken.


Daarop aansluitend moet sturing bestaan uit het juiste pakket van geconditioneerde beloningsprikkels.
En zo is gaandeweg in de afgelopen twee eeuwen een goed deel van de op community-leest geschoeide maatschappelijke verbanden opgelost en zijn de betreffende maatschappelijke functies overgenomen door moderne organisaties gebaseerd op verticale sturing van individuen. Stelsels die konden functioneren op basis van de activering van *moral/social goals* door mensen in verband met een gedeelde *beliefs* en *purpose* werden vervangen door op *ratio* en *calculatie* gebaseerde prikkelsystemen.

En nu worden we dus geconfronteerd met de grenzen van deze governance stijl. Die grenzen zijn tweeërlei. Eerder is al gewezen op het feit dat onze gangbare manieren van organiseren en sturen in de praktijk steeds minder effectief zijn en zelfs meer en meer onbedoelde en averechtse effecten genereren. Al begin jaren ’80 van de vorige eeuw formuleerde Roel in ’t Veld zijn beroemde wet van de afnemende effectiviteit van beleid:

“De wet van de afnemende effectiviteit van beleid houdt in dat, uitzonderingen daargelaten, in de loop van de tijd de onbedoelde effecten in belang zullen toenemen en de bedoelde afnemen. Dit als gevolg van leerprocessen aan de kant van de bestuurden. De stereotype reactie van de zijde van beleidsmakers op afnemende effectiviteit zal beleidsaccumulatie zijn, bestaande in de totstandkoming van meer beleid, meer gedetailleerde regels, meer controleprocedures, et cetera. Afnemende effectiviteit en beleidsaccumulatie spelen haasje over, totdat het beleidsgebouw onder het eigen gewicht bezwijkt, een crisis ontstaat, die de weg vrijmaakt voor het inslaan van geheel nieuwe wegen.”

De bestuurder heeft een plan en probeert met geconditioneerde beloningsprikkels de bestuurden (burgers, werknemers, ...) ertoe te brengen om hun gedrag te veranderen of althans te doen wat gedaan moet worden om dat plan te verwezenlijken. Misschien schikken de bestuurden zich en doen wat nodig is om de aangekondigde beloning te incasseren of straf te ontlopen – maar ook niet meer dan dat. Misschien ook zoeken ze de randen op van de controle of schieten er gaten in en plegen lijdelijk verzet.

De reactie daarop bestaat uit meer regels en controle. Zo wordt een negatieve en destructieve spiraal gevoed tussen sturende bestuurders en lerende bestuurden die het stelsel ondermijnt en te gronde richt.


17 Als we de Gallup - State of the Global Workplace 2013 (p 91) mogen geloven is slechts 9% van de Nederlandse werknemers *engaged in their jobs* — *that is, they are emotionally invested in and focused on creating value for their organizations every day*. Maar liefst 80% van de Nederlandse werknemers is niet *engaged*, en 11% *actively disengaged*. Wereldwijd zijn deze cijfers 13 % engaged, 63% niet engaged en 24% actively disengaged.

Deze dynamiek kan zich voordoen ook al zouden de bestuurden het doel van het plan (betere producten, minder verkeersdoden, een schonere leefomgeving) in principe misschien wel onderschrijven en aan de realisering ervan willen meewerken. Maar het is juist de verticale sturing met beloningsprikkels die hen ertoe aanzet om dat doel verder te laten voor wat het is en het niet als normatieve maar als gain goals te frame: hoe ontsloop ik straf c.q. hoe krijg ik de hoogste beloning met zo gering mogelijke inspanning c.q. met het hoogste genot?

Het eerste probleem, of defect, van deze governance stijl is dus dat ze steeds minder effectief is en steeds meer onbedoelde en averechtse effecten geneereert, met name als gevolg van de wijze waarop sturingsimpulsen worden verwerkt door de individuele bestuurden.

**Het échte probleem is: sociocide**

Een tweede probleem van deze governance stijl is echter van veel ernstiger aard; en dit probleem staat geheel los van de vraag of de sturingsinterventie effectief is of niet. Dit tweede probleem is vervat in de vraag:

> wat zijn de effecten van deze governance (i.e. sturing met geconditioneerde beloningsprikkels van geïndividualiseerde bestuurden gezien als rationele en autonome personen) op de morele, sociale en creatieve vermogens van de bestuurde mensen, op hun relaties en op de resilience en vitaliteit van hun verbanden en het sociale systeem?

De effecten van de introductie van sturing door middel van geconditioneerde beloningsprikkels op mensen, relaties en verbanden zijn mooi te illustreren aan de hand van – een geparafraseerde versie van – de bekende casus van de kinderopvang in Israël 18.

Ouders zetten een crèche op in de buurt; samen de schouders eronder. Ze kiezen een bestuur, ze nemen een paar jonge enthousiaste juffrouwen in dienst en ze verdelen de taken, de lusten en de lasten. Na verloop van tijd doet zich het probleem voor dat er ouders zijn die soms hun kind te laat ophalen en zo de juffen verplichten om langer te blijven. Het bestuur besluit om een boeteregeling in te voeren. In tegenstelling tot wat beoogd werd, neemt het aantal keren dat kinderen te laat worden afgehaald toe; het verdubbelt zelfs. Vervolgens besluit het bestuur om de boeteregeling weer af te schaffen. Het aantal laatkomers daalt echter niet maar blijft constant op het hogere niveau.

Zoals we in een voorgaande paragraaf al eerder deden is deze casus te analyseren in termen van averechts werkende sturing als gevolg van de crowding-out van moral/social goal framing door gain goal framing. Waar ouders onderling en in relatie tot de juffrouwen eerst moreel-sociale afwegingen framen (met noties als persoonlijke verantwoordelijkheid, vertrouwen, schaamte; hulp inroepen alleen in noodsituaties), werd door de invoering van een geconditioneerde beloningsprikkel deze hulp geframeerd als een extra service met een prijs. Heeft deze verschuiving naar gain goal framing zich eenmaal gecentraliseerd en vastgezet, dan is zij ook moeilijk terug te draaien. Maar het effect van de introductie van sturing door middel van een geconditioneerde beloningsprikkel reikt verder en dieper. Parallel aan de veranderingen in de motivaties van de betrokken individuen is door de geïntroduceerde beloningsprikkel ook de aard van de relaties tussen de betrokkenen fundamenteel veranderd. En bij uitbreiding: ook de aard van het sociale systeem is erdoor veranderd. Waar eerst sprake was van een betekenisvol verband, een community van mensen die samen verantwoordelijkheid namen voor een gedeeld streven en elkaar daarop aanspraken vanuit een gevoel van verbondenheid en een gedeeld engagement, veranderde het stelsel naar een

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regel- en prikelgestuurd systeem van onpersoonlijke en transactionele relaties. Door de invoering van de beloningsprikel – op zich een vrij onschuldig lijkende maatregel – zijn de relatielogica en de systeemlogica definitief veranderd. Was de crèche eerst een relational good (zie verderop), het is nu een consumptiegoed.


Maar tegelijkertijd gaat deze interventie gepaard met een massale en stelselmatige afbraak van de bestaande verbanden en aanwezige engagementen, van individuele en collectieve vermogens in de samenleving. Het uiteindelijke resultaat is een verzakte, gefragmenteerde, hufterige en vermoeide samenleving. De succesvolle interventie - succesvol in its own terms – is dus tegelijkertijd ook een misdaad. Een misdaad, die ik eerder sociocide heb genoemd, en die bijzonder is omdat hij gepleegd wordt door fatsoenlijke en intelligente bestuurders en professionals die worden gedreven door nobele motieven.19

Die misdaad bestaat er niet alleen uit dat bestaande capaciteiten en andere kwaliteiten van personen en verbanden worden afgebroken, die verbonden waren met de oude arrangementen die door het nieuwe stelsel obsoleet zijn gemaakt en verdwijnen – zoals particuliere, familiale, territoriaal-communale en andere arrangementen voor armen-, ouderen- en buurtzorg, caritas en diaconie, maar ook voor opvoeding en onderwijs, veiligheid, onderhoud van de publieke ruimte etc. Het feit dat betreffende maatschappelijke functies overgenomen werden door bureaucratisch gestuurde instellingen betekende immers ook dat de bestuurden evenzovele motieven en subject matter worden afgenomen om samen met anderen in nieuwe betekenisvolle verbanden nieuwe vermogens te genereren. Hun problemen worden hen voortaan afgenomen. Terwijl het juist de door de betrokkenen ervaren problemen zijn, de dingen die gedaan moeten worden, die motief en materie opleveren voor mensen om zich te engageren, samen aan de slag te gaan, te leren en probleemoplossend vermogen te ontwikkelen, kortom: om vitaal en veerkrachtig te wórden, individueel en in allerlei betekenisvolle verbanden en netwerken.

Natuurlijk is het onjuist om de bestuurders en professionals tot exclusieve daders van sociocide te benoemen, en de burgers tot slachtoffer te verklaren. De verzorgingsstaat onteemt mensen taken en motieven om samen aan de slag te gaan, en stelt hen omgekeerd in staat en prikkelt hen om de verantwoordelijkheid voor die taken af te schuiven en over te dragen aan de overheid; dat is juist. Maar – in een democratische setting zijn het per ende de mensen zelf geweest die steeds meer taken aan de overheid hebben overgedragen, en daarmee de materie en motieven voor hun eigen creatieve, morele en sociale ontwikkeling. In deze zin is het juister om te spreken van sociocide als een misdadig systemisch arrangement. En vanzelfsprekend was dit nooit de bedoeling van de bedenkers van het arrangement; die dachten immers zo de randvoorwaarden te scheppen opdat autonome individuen zich zouden kunnen ontpleoien en samen een vitale en gelukkige samenleving vormen. Maar: een vitale samenleving, vitale organisaties worden niet gemaakt door autonome

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19 Cor van Beuningen: *Hoe maken we een vitale samenleving?*, in Wereld en Zending, 2004/3; idem: *De omgedraaide organisatie*, in Perspectieven op MVO.nl, Assen 2012; idem: *Goed en Kwaad - Over binding in de samenleving*, in B. Musschenga e.a. (red.) Het Kwaad, Reflecties op de zwarte zijde van ons bestaan, Vught 2011
individuen. Mensen kunnen hun creatieve, morele en sociale talenten alleen in verbinding met andere mensen ontplooijen, in betekenisvolle verbanden.

Omdat de “succesvolle” interventies in het kader van de verzorgingsstaat tot gevolg hebben dat de probleemoplossende vermogens van de bestuurden zelf afnemen, wordt de noodzaak van nieuwe en omvangrijkere externe probleemoplossende interventies navenant groter. Deze interventies scheppen hun eigen vraag en genereren zo een infernale spiraal die eindigt met het ineenstorten niet alleen van het beleidsgebouw maar ook van het gehele sociale systeem, wanneer alles wat gedaan moet worden is georganiseerd in bureaucratische regel- en prikkelsystemen.

Overbodig om te zeggen dat al die maatschappelijke functies werden overgenomen door instellingen die allemaal maar één manier van organiseren en besturen kennen: een besturende top die met regulering en beloningsprikkels individuen disciplineert en conditioneert.

**Sociocidale governance voorbij**

Elk governance arrangement dat gevormd wordt door een sturende bestuurder enerzijds en geïndividualiseerde bestuurden anderzijds, en waarin dus geen ruimte is voor betekenisvolle verbanden waarin bestuurden hun creatieve, morele en sociale kwaliteiten aanspreken en ontwikkelen, ondermijnt zichzelf en het sociale systeem. Probleem is dat een bestuurder mensen niet kan dwingen of sturen om hun morele en sociale kwaliteiten aan te spreken en ontwikkelen. Wat hij wél kan is:

- het inrichten van arrangementen en beïnvloeden van processen waarin mensen in betekenisvolle verbanden als vanzelf hun morele, sociale en creatieve kwaliteiten activeren en ontwikkelen.

Dat lijkt misschien moeilijker dan het is. De volgende observaties en instructies zijn bedoeld om hem/haar alvast een eind op weg te helpen.

1. Mensen spreken hun creatieve, morele en sociale vermogens niet aan, en ontwikkelen die talen niet onder sturingsdwang; als ze al ontplooid worden is dat in vrijheid. Als het gaat om de ontwikkeling van de moraliteit en socialiteit van mensen is daarom alles onvoorspelbaar; wat er op dit vlak met en tussen mensen gebeurt, is niet te plannen, te sturen of af te dwingen. Mensen ontwikkelen die talenten alleen in relaties en interactie met andere mensen, in voor hen betekenisvolle verbanden, en bovendien ook nog eens vaak als onbedoeld bijeffect daarvan. Dus een garantie dat het ook inderdaad gebeuren zal, is er niet.

2. Het motief om relaties met elkaar aan te gaan wordt mensen aangereikt door verschil en diversiteit in het sociale systeem. De interactie die op basis daarvan plaats vindt is in eerste instantie functioneel van aard, d.w.z. gericht op het realiseren van een bepaald doel. Maar – en dit is cruciaal - in deze relatie, in dit proces van samen aan de slag gaan, kan het gebeuren dat mensen behalve instrumentele en strategische vaardigheden ook emotionele en affectieve lagen activeren en gaandeweg sociale disposities en moreel besef ontwikkelen. En hier is het allemaal om begonnen. Want het is in dit proces dat mensen hun creatieve, morele en sociale vermogens, eigenschappen en disposities als empathie, integriteit, engagement en generositeit aanspreken en ontwikkelen. In dit proces genereren ze tevens iets wat buiten hen als individuele personen bestaat, iets wat daarvóór niet bestond: vertrouwen, loyaliteit, moreel en sociaal kapitaal, sociale cohesie, vrede; gemeenschap. **Deze eigenschappen en disposities van mensen en van hun verbanden zijn emergent, dat wil zeggen dat ze niet herleid kunnen worden tot de individuen maar dat ze ontstaan en zich**
voordoen in relationele processen, en doorgaans als onbedoeld bijeffect daarvan. In en door relaties ontstaat een nieuwe ontologische laag in de werkelijkheid.


4. Niet alle interactie heeft zulke emergente bijeffecten. Of die zich zullen voordoen hangt van de betrokkenen zelf af, niet in de zin dat zij die effecten moeten nastreven, maar meer in de zin dat ze zich er gaandeweg voor open stellen, dat ze het met zichzelf en de ander – samen – laten gebeuren en er zich vervolgens aan committeren.

5. Ook van buitenaf is een relationeel proces niet op deze uitkomst te sturen. Wel kan inzicht in aard en dynamiek van het proces behulpzaam zijn om het in ieder geval niet op voorhand te frustreren en misschien zelfs te faciliteren. Vaste onderdelen ervan zijn:
   a) een gedeelde sense of purpose, een gedeeld streven en de ervaring dat ieder bijdraagt aan een hoger doel d.w.z. aan iets wat groter is dan het individuele zelf
   b) een gedeelde sense of agency. Onze inzet doet ertoe en maakt het verschil; aan ons is de ruimte/vrijheid gegeven om het zelf te doen, we zijn zelf en samen verantwoordelijk voor het resultaat en we gaan het in ons gestelde vertrouwen niet beschamen
   c) een sense of community, een gevoel van verbondenheid en een gedeeld engagement.

5. Al deze kenmerken zijn ingrediënten van het voortgaande proces, en tegelijkertijd zowel resultaat van dit proces als ook weer voorwaarden voor het vervolg. Het zijn emergente eigenschappen van zowel de betrokkenen individueel als van het verband dat ontstaat; en het zijn eigenschappen die mensen zowel ervaren als – onbedoeld – ontwikkelen in het relatieproces en die tegelijkertijd dat proces verder brengen en verdiepen, waarbij de subject matter van de relatie verandert in een relational good.

Die subject matter – een probleem, een conflict, een opdracht etc. – is dus de aanleiding tot het contact; in het relatieproces verandert het in een relational good; en het is dan zelf weer vehikel voor het voortgaande proces van relationele praxis. Een good wórdt dus relational doordat het als zodanig geframed en herkend wordt in het proces van relationele praxis; en het bestaan ervan als relational good is onlosmakelijk verbonden met de voortgaande relationele praxis van de betrokkenen.

6. Omdat bedoelde emergente fenomenen alleen ontstaan en bestaan als bijeffect van interactie is het van eminent belang dat mensen niet de motieven worden ontnomen om relaties aan te knopen en samen aan de slag te gaan. Een bestuurder moet daarom de bestuurden zoveel mogelijk de motieven én de ruimte laten om zelf en samen aan de slag te gaan, om doelen te stellen en processen in te richten, om betekenisvolle relaties aan te gaan in betekenisvolle verbanden. Hij moet hen, anders gezegd, de vrijheid laten/geven om zelf en samen verantwoordelijkheid te nemen. Of

beter nog: hij zal hen daartoe zelfs motieven verschaffen en nieuwe ruimte scheppen. De bestuurder moet bestuurden helpen en aansporen om te doen wat gedaan moet worden met het oog op het gemeenbest. Helpen, in de zin van het wegnemen van blokkades en van het aanleveren van middelen en van voorstellen, zonder echter te treden in de vrijheid en de verantwoordelijkheid van de ander. En aansporen, door de ander te wijzen op diens eigen verantwoordelijkheid en vanuit zijn positie en met hetgeen in zijn vermogen ligt bij te dragen. Zo’n relatie is ook altijd wederkerig: mensen helpen elkaar en sporen elkaar aan om een optimale bijdrage te leveren aan het doel waarvoor ze de verantwoordelijkheid delen (als relational good).

Cor van Beuningen is directeur van Socires

Literatuur

Is There a Way to Escape Policy Gridlock?

[Review Colander/Kuper: Complexity and the Art of Public Policy]

Mark Buchanan

From financial regulation to health care to climate change, we can't agree on what to do about anything. Free-market enthusiasts celebrate the creative power of markets and want smaller government; critics counter that we desperately need government intervention to solve problems that markets can't handle. Neither side can understand the other.

Is there any way out? Well, if you're discouraged, I suggest looking to an inspiring new book by an economist, David Colander, and a businessman, Roland Kupers, who believe the deadlock needn't be permanent. We can have better markets, they say, and more effective (and smaller) government too, if only we can muster a little more economic imagination.

The book is called "Complexity and the Art of Public Policy," and its main point is that our policy debates have fallen into a trap that economists inadvertently created some 50 years ago. That's when they started building mathematical models of economic systems, and, to simplify things, made the assumption that people have fixed or unchanging preferences and desires. Sounds innocuous; it wasn't, and isn't.

That's because this assumption has led us to accept that the aim of policy is never to influence individual preferences or values, only to satisfy pre-existing desires as well as possible. A few steps from there and you have conventional economic wisdom -- that decentralized markets do a wonderful job creating wealth and meeting the vast diversity of human wants, but also that markets fail for a variety of reasons. We need government to step in when they do; for example, to supply socially valuable public goods such as broad education and clean air.

Hence, we're stuck with a policy framework that says either "leave things to the market," or instead "count on government" -- a recipe for polarization. By assuming that people have fixed preferences, Colander and Kupers write, economists have effectively ruled out an entire world of policies that might actually get markets and governments working together more imaginatively.

After all, market enthusiasts are right that the free activity of millions of people seeking their own ends is an incredibly powerful way to find solutions to human needs. Central planning can't match local knowledge and creativity. However, the prevailing values of the markets -- valuing financial gain over all else -- means that market ingenuity isn't often directed toward social benefit. Here, Colander and Kupers argue, government has a role, not in finding any solution, or producing any good, but in encouraging institutions within which new values could emerge, helping the market to achieve socially beneficial outcomes.

For example, new kinds of "for-benefit" businesses have already started emerging, and could be further encouraged by government groundwork. Examples include Ashoka.org, an umbrella organization aiding for-benefit enterprise, or Patagonia, the outdoor-gear company devoted to environmental responsibility and -- since 2012 -- officially listed under California law as a “benefit organization.” To thrive, such organizations require a legal framework attuned to their social focus -- including rules designed to maintain a commitment to the values and culture of the founding entrepreneurs.

With a significant shift in prevailing values, such businesses could compete quite well with for-profit companies, attracting employees with shared norms to work for them, or doing business on favorable terms with other for-benefit firms. In such a world, the government needn't step in for market failures; it would only help create a level playing field so that for-benefit businesses could succeed, enabling the magic of markets to supply social well-being as well as material growth. Imagine new companies devoted to supplying cheap and effective drugs and aiming to maximize social benefit rather than profit. Or companies with an earnest mission to deliver quality health care while keeping costs down.

Recognize that preferences aren't fixed -- and that policies might aim to encourage their evolution -- and you can begin to see how markets and government might work together. Social entrepreneurs could help markets themselves achieve social goals, giving more freedom to individuals, and shrinking government at the same time.

Unfortunately, little of this happens now because institutions haven't been designed to be friendly to social entrepreneurs. Academic economics is behind the curve too. It should be exploring the kinds of institutions that would be most beneficial in bringing such a world about. It isn't, because most economists remain locked in the old policy frame, as do the policy makers and politicians they influence.

Colander and Kupers's book ought to be on every policy maker's reading list. They suggest that we can get ourselves out of the boring old debates, but it will take a little imagination. And the willingness to see that some of the things we think we “know” are precisely what keep us stuck where we are.
Capitalism and Inequality

The failure of the free market as a challenge for the Rhineland model

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Summary
Since 1960, the primary focus in the relation between capitalism and inequality has been the increasing gap between poor and rich countries. In the last ten or twenty years, this gap has been decreasing, sometimes even dramatically. Globalization, the emergence of the free market philosophy, combined with various economies’ own efforts as well as those of development cooperation have cut world poverty by half.

The attention has therefore shifted to a growing inequality between developed, emerging and under-developed economies. Poverty and inequality are still persistent characteristics of the capitalist system, which is why a lot of people are increasingly in favour of redistribution mechanisms between rich and poor within societies, for example by (re)introducing progressive taxation and stopping the mechanisms that legally and illegally further inequality. Yet the question remains whether this approach does full justice to the complex question of capitalism and inequality.

As important as those financial and economic tendencies in a certain country may be, there are also other causes and dimensions.

Research often shows that far too little attention is paid to indirect economic factors. A stable family situation, stimulating education and good nutrition during the first thousand days of one’s life; a safe, stimulating and controlling environment, good and relevant schooling and also ethnical and religious conditions may be very important. Sometimes redistributive policies prove to be counter-productive and a non-activating welfare state even tends to lead to lasting poverty. Efforts to keep extreme wealth and its expressions within bounds will not be enough if they are not accompanied by a new ethical kit and perhaps even a cultural change. But most of all, measures that are taken only on a national scale will be ineffective and even futile. What is needed is a new, worldwide financial architecture that rules out the possibility of easy circumvention of restrictions, that punishes free rider behaviour by countries, that promotes the proper basic conditions for the functioning of a global market and that—perhaps—can even levy some sort of international tax.

But of (at least) equal importance is to examine the relation between capitalism and inequality in a broader context. Here the following four dimensions are concerned:

» First of all, there is the persistence of poverty and subordination for 10 to 20 percent of the world population, both in rich and in poor countries.
» Then there is the vulnerability and undervaluation of the other parties concerned in the functioning of the market next to shareholders and financial suppliers, i.e. the environment and the labour conditions.

» Thirdly we see, in contrast to a growing middle class in the developing countries, the disruptive impoverishment and shrinking middle class in many developed countries.

» And finally, there is the excessive increase of wealth and income of some upper layers in society, both in poor and in rich countries. Sometimes, this is caused by corruption, sometimes by a lack of efficient regulations. Only 0.01% of the population in the US (and probably also in Russia), not only has a dominant financial position but also a determining political influence.

Precisely these different dimensions constantly require a different, yet coherent, approach.

» The persistent poverty at the bottom of society requires public authorities—not only in society but also in trade and industry—to pay attention to education and schooling, security, care and specific stimulation towards economic participation, e.g. micro credit.

» Environment, working conditions, human rights and other non-financial aspects, in combination with individual responsibility, regulations and especially new price mechanisms (such as the true price initiative), should all be duly reflected in adapted market mechanisms.

» The social (and ecological) market model, as translated in the Rhineland and Scandinavian system, gets increasing appreciation in other countries and especially among former defenders of the Anglo-Saxon model. Yet at the same time we should seriously consider an update. For many poor and growing economies, it may be a clear alternative to either a socialist model, or to a complete free market ideology. But also in richer countries, it may contribute to the recovery of the position of the middle class and give a new perspective to employment and growth. A transformation, not an abolition of the welfare state, will be part of it.

» The excesses and abuses at the top income and fortune layers of society require measures and regulations on a national scale but they have to be completed with global arrangements. Those arrangements will thoroughly transform the Bretton Woods system and initiate a global super-national financial architecture. The reality of globalization can only be matched within systems of law and sanction. But even that will be insufficient, in this field as well as in the field of human rights violation, if there is no new ethical approach to the concepts of market, income and the meaning of prosperity.

These macro-economic and macro-political realities also have consequences for our own preferences, choices and behaviour.

» Attention and dedication to social cohesion and bonds remain irreplaceable
for the fight against poverty in our own country, and also for individual citizens. The various forms of international solidarity remain equally essential, especially when focused on the causes of poverty and the liberation from this yoke of the lowest layer of a billion fellow citizens. More modern ways of intelligent assistance, such as carefully programmed micro-credits, can have a lever effect.

» Individual purchase and consumption behaviour, consumers’ actions for fair trade, shareholders’ activities and responsible entrepreneurship are critical for a new balance on the market of supply and demand, whereby sustainability and labour conditions, as well as other social values, play a role.

» The regaining of faith by and in banks and financial institutions should be part of a broader discussion about cultural change wherein the taboo on discussing the relation between ethics and money is lifted, and wherein a realistic contribution to the necessary vision on a new global financial architecture can be developed.

For a humane society to have a real perspective, we need to reconcile modernisation and industrial production on the one hand, and humane labour conditions on the other. We have to reform without throwing away values such as human dignity, responsibility, solidarity and subsidiarity. If it appears from data and numerous publications that choices made elsewhere that favour raw capitalism lead to dislocating and sometimes devastating results, then we should be critical and contribute much more to the essential national and international debate on the establishment of a social market economy on a global level.

**Derailment of the system**

A small farmer in Indonesia, a country with a rapidly growing economy, symbolizes the bottom 20 percent of the world population, *i.e.* those who cannot participate, do not benefit from the globalization and do not profit from the free market or the capitalist system. At the end of the 19th and beginning of the 20th century, the same was true for the small holder in Western Europe, who was at risk of missing the boat of increasing prosperity. In both cases this is about inequality, in many cases a growing inequality of income and of opportunities.

Then suddenly, one realises that this is not only about the small farmer in Asia. It is also about the factory worker in the US, or about the cashier in Walmart, or about the elderly in eastern Europe or the school drop-out in Spain.

**The bottom of society**

Globalization and the free market have promoted equality between what we once
called the poor and the rich countries and the world map of poverty has subsequently changed drastically in the past 25 years. This was realised with the help of technology and the spirit of enterprise and freer markets, but it was also thanks to education, nutrition, healthcare and better water. Nevertheless, it appears that for ten, twenty, sometimes even thirty percent of the population, there was marginal to no benefit from the economic developments, the technological breakthroughs, the free market or the globalization. In recent and in older studies abundant questions have been asked as to why this is.

An important cause of inequality is that the basic conditions for a well-functioning market are deliberately violated in a number of countries, through monopolies, corruption, and conflicts of interests between politics and commercial life. In a recent article in *Foreign Affairs* about ‘Capitalism and Inequality’, Jerry Muller also points out a number of completely different causes. The glass ceiling to progress is made impenetrable not only because of macro-economic and political factors, but socio-cultural and ethical factors as well. It is about the instability in education in a family where, for example, the father is absent, and also the lack of a supporting and guiding social environment. “One can hardly overestimate the role of the family,” he says, relying on extensive research. And “nothing can replace that emotionally and culturally supporting family.” Stability, intimacy, solidarity and supervision by one’s family, social environment, and church communities are extremely important in creating opportunities to break free from poverty. It also shows why some ethnic and religious groups do better than others. It is not without good reason that so many poor people manage to escape the bonds of poverty.

Muller then goes a revolutionary step further. He says that without important public expenditures in the social field, no answer will be found to a number of inherent characteristics of capitalism. “The welfare state is not a beast to be starved!” The systematic limitation, demolition or wrong direction of the welfare state as we have seen since Reagan is, according to Muller, one of the main causes of the loss of the American dream and of the persistent presence of poverty in the bottom twenty percent in the US and elsewhere. According to *The Economist*, a paper that can hardly be suspected of anti-capitalist ideas, the question is, how long a policy such as that of the Chinese can be reconciled with social peace and economic growth. Governments from Brazil and India for example have introduced adjustment programmes to benefit the poorest, and their reasons for doing so were not particularly doctrinal.

Those who believe the welfare state is outdated will sooner or later realise that if that were the case, the free market will also come under severe pressure. After all, a free market does not work well with growing inequality and a lack of perspective for

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1 The reason the economic growth in Indonesia did not follow the neighbouring countries, was determined to be due to the fact that foreign investments in this country were thirty percent more expensive due to “transaction costs”, as they called them euphemistically. This resulted immediately in unequal opportunities for those still under the poverty line.
ten to twenty percent of the population. Analysts and opponents of ‘big government’ say that the present financial and economic crisis would benefit from an increase of expenses on luxury consumer goods, expensive cars, jewellery or wealthy apartments. We are talking here about some hundreds of thousands of the super-rich. I wonder what would happen if the bottom twenty percent, say sixty to eighty million people in the US, would start to have some more purchasing power, as President Obama was striving for at the beginning of his first term. What would happen if that bottom billion would get two instead of one dollar each day? Now that would give a real impulse to the (global) economy!

The high-profile economists and politicians of our multilateral institutions and also the frequently cited opinion makers are often rather unfamiliar with the real world of the poor. According to Wijffels, they are even unfamiliar with primary processes like food production. Most of all, they are unacquainted with the economics of the poor. That is why economic growth often excludes the poor, leaves them to be poor or makes them even poorer.

If you don’t take the economics of the poor into account, the consequences can be catastrophic. When President Clinton wanted to promote the ownership of a house among the poor and stimulated mortgages by offering commissions to brokers, it worked out to be a perverse stimulus because the basic conditions to create the capacity to repay were lacking. The entire world now suffers from the consequences.

Meanwhile, it’s not just the poorest that are affected. Almost as shocking as the observation of persisting poverty and exclusion in the bottom layer, is the relatively recent recognition that these imperfections have two other victims, namely the environment and labour conditions on the one hand, and the middle class, in particular in the developed countries, on the other.

The most vulnerable

We were already aware of the fact that the environment is excessively burdened and becoming exhausted. In Arjan Broers’s very instructive book, Geld en Goed, Herman Wijffels, a former Dutch top banker and Executive Director of the World Bank, points it out as follows: “The carrying capacity of the earth is overburdened by fifty percent. In financial terms this means that we don’t live on the return but on the capital itself. So we use up our capital.” And obviously this overburdening has to do with our greed and consumption behaviour or, in other words, our morals. But to say that the lack of morality is the only reason, is to return us to the night watchman state of the 19th century—because it is not only my lack of sobriety or renunciation of the golden calf and not only my attachment to other values, which causes this exhaustion and overburdening. It is also caused by a failing market mechanism. The cheap furniture made of hardwood from ancient forests is in reality invaluable. A holiday by air in Europe should be much and much more expensive than a train holiday. But
for many goods and services the transactions are ruled by supply and demand and take far too few other aspects into account to determine the real costs. These aspects are the damage for the environment caused by transport, exploitation, noise, cruelty to animals, harmful pesticides, health in general, removal of essential elements for future life such as biodiversity, regeneration capacity and the valuation of human communities. Market mechanisms with systematic imbalances are maintained because incentives for alternative energy such as true innovation, cleaner combustion engines, promotion of regional products, decent production processes and so many other things are still missing.

Most definitely, something is brewing. Young people will individually choose more consciously and the situation will really improve when worried consumers join forces in movements and public actions.

Public interventions made corrections to our market in the first half of the previous century and in the same way we now cannot just rely on voluntary actions. We needed laws to forbid child labour, to restrict dismissals, to protect cooperatives, to facilitate societal and workers’ insurances, to fight against poverty for the most vulnerable. This was the core of the social market model, or the Rhineland model. In essence this model is a correction on the functioning of the market, especially in the area of labour conditions. Despite strong opposition, there was the conviction that the market needed correction but should not be eliminated.

Now we are again speaking of a correction, but with two essential differences. It is not only about vulnerable people, but rather about the vulnerable, the helpless—in one word: Creation. And here no unions of stakeholders are around. That’s the reason why politics can get away so easily with delays, immobility or false solutions. This can only be changed if ethical and moral power stations in society link with opinions and movements that go further than simply having more and using more. Churches and world religions could make the difference here.

And there is a further essential difference and complicating factor. What we need is authority, one that can really formulate and impose corrections. For example we have the WTO, the World Trade Organisation, but they operate on a voluntary basis. We need a transformation that goes much further. We need to create an effective form of a world authority that is able to steer the rather hard globalization with legal power.

For many years, the World Council of Churches and the Catholic Churches has argued for such a direction, and only recently the Pontifical Commission for Justice and Peace published a report titled Towards reforming the international and monetary systems in the context of global public authority. The starting point here is that globalization is not always wrong and we cannot do without the market, but a whole lot of things have to change. These changes should lead to forms of worldwide authority. It is the translation of the principle of subsidiarity but then upwards. Many real specialists of the haute finance were involved and it plots a realistic and doable path.
The middle class
A sense of realism is therefore needed, because another phenomenon has come like a bolt from the blue in the past recent years. It is the stagnation and falling behind of the lower and middle incomes in most developed countries. For three or four generations we’ve experienced progress in our countries and this had an influence on our culture and our attitude to life. Upon the arrival of steam engines and washing machines, cars and microwaves, the necessity to physical labour diminished and people, notably women, were even freed from being housebound. Healthcare made most diseases curable or preventable. Schooling, ranging from primary to academic levels became accessible for everybody, it formed people more and more, making them available for new kinds of jobs. The computer gave access to information and cultural domains that were previously only attainable for the elite. And this was combined with an ever-increasing income, generation after generation. Ownership of a house became more and more attainable, as well as all kinds of luxury goods. The American Dream spread to Europe. A labourer’s son could become the CEO of a listed company, his wife being a senior medical specialist.

The issue which really puts the debate on capitalism and inequality on edge is the position of the middle class. The middle class as a ‘reception room’ for the poor and a bridge to capital and higher education, turned out to be the basis for stability, democracy and economic growth. The best economic news of the past two or three decades was the rising and developing of a middle class in both developing and post socialist communities. That was real progress.

But in the aforementioned special of The Economist, it appears that—at least in the US—the middle class is not making any progress but that it is, together with the layer just underneath, becoming poorer. For twenty, perhaps thirty years, this was concealed because the family income increased or stayed the same. The partner took a job, both partners worked longer and kept on working later. And then there were the debts, debts, debts… They concealed the fact that individually things were not all together as good as they appeared. And collectively, the debts were used to finance a part of the welfare state. In other words, the magnificent boom, that incredible growth of income and expenses was financed with … borrowed money. (I quote again Wijffels in Broers’s book).

Suddenly, here and everywhere, one realises that things are perhaps different: limits to growth, income, expenses, work, property, and even to education. It is not only about slowing growth rates. On the one hand we have the diminishing inequality between North and South, and on the other hand we see that inside these countries inequality does not decrease, but rather it increases. We also see another kind of inequality. What first was limited to the bottom 10 percent, is in the US now threatening to spread and lead to new ghettos of segregation according to ethnicity, family structure, regional differences. In Europe we see a new dividing line between language, culture and countries. There is no longer a division between east and west.
but there is a new demarcation line between south and north with the Polish and Czechs as new winners and Greeks, Spaniards and Italians as losers. There is the great disillusion for young people newly arriving on the labour market, including the highly educated: you aren’t needed, not now and maybe not even later. It is a double disillusion as it also applies to the parents who saved for their children’s studies.

For quite some time, there’s been something wrong with the idea of automatic progress, but the financial crisis in the US and later in Europe swiftly unmasked it. The doubt about whether it’s worth it for me or my child to pursue higher education is in fact the doubt about whether progress is still attainable or—nearly everybody’s worry—whether future generations will be as well-off as we are. It’s no wonder we see the rise of new economies as a threat to ours, that we wrongly think the piece of the pie for ourselves will be smaller if it gets larger for someone else.

Something doesn’t make sense: the preservation of our level of prosperity, let alone an improvement in our countries, obviously needs a drastic adjustment of the market mechanisms. It is our own insecurity that prevents us from realising how comfortable we still are here in the countries with the Rhineland and Scandinavian model. An avalanche of studies and articles appears in the US, criticising the system based on the Anglo-Saxon model which was prematurely declared invincible in 1989. Free market, fine, but if it leads to a greater inequality, to the melting down of the middle class, then something is structurally wrong. And if in Scandinavia and in the countries around the Rhine this inequality continues to decrease and the middle class with its prosperity keeps in a strong position, should we then not take a careful look at the system? One has found a measure for this, the so-called Gini-coefficient. It is an indication of how much inequality increases or decreases. We do rather well on this indicator, although we feel something is brewing, at least concerning the economic climate. And perhaps among large groups the motivation and belief needed to make progress has come under pressure, especially among the 5 or 10 percent of those who seem to get stuck in poverty as we explained earlier.

The top of the pyramid
Meanwhile the discussion is primarily about the other side of the picture, the top. Since the Reagan years, since Milton Friedman—the apostle of absolute deregulation—, since Ayn Rand—the ideologist in favour of blunt self-interest—, nothing has lead to a greater inequality than the explosion of the wealth of the upper one to five percent. But it is not about jealousy, it is primarily about the question whether the explosively growing richness of the happy few perpetuates or even worsens the poverty of millions of others. The Asian Development Bank says that, due to this increasing inequality, at least 240 million people stayed under the poverty line.

One percent of the population of the US is responsible for 20 to 25 percent of the national income. The income of the top 0.01 percent of the US, 16,000 families,
has quadrupled their income since 1983. The bottom 20 percent has raised their income only with 0.4 percent. And why? It is not only about entrepreneurship, seizing opportunities or speculations. Mechanisms that, directly or indirectly, specifically benefit the rich and richest, have crept into the aid system. That is how the amount of tax reduction on the houses of the richest 20 percent is four times as big as the amount spent on social housing for the poorest 20 percent. Even more serious is that 200 Americans are responsible for 80 percent of the donations to political parties, donations that amount to billions and billions.

Deregulation, the absence of the notion of society’s interests rising above the sum of all the individual interests, the conviction that a welfare state makes people idle, the absence of a social dialogue, the incorrect assignment of financial aid, the dependency on politics and vested interests of a very small elite: they are all failures in a capitalist system which is untenable in this form. And with respect to the absence of a social dialogue, a large number of authors have raised the question of whether we should not look a bit closer into the social market model, i.e. the Rhineland and Scandinavian models. After all it is about system failures, failures that in the first place ruin society in the US. But they get an extra dimension as soon as they contaminate the financial and subsequently the economic system in the entire world, as was the case in 2008. One cannot think of a more dramatic example of the deterioration and, more specifically, the inadequacy of the world order to manage a crisis or prevent abuses.

In our digging for causes and remedies, we failed to emphasize the lack of a standard, the necessity of decency and virtue. Greed is not bad, we hear, it is good because the sum of every individual greed produces a maximum of prosperity; don’t hamper us with regulations and controls; and in politics and in society one should not refer to the general interest because we can neither measure nor impose it.

In the financial world there are greedy predators running around that need to be locked back up in their cage, a cage of a worldwide dimension. The cage bars of the post war institutions that were meant to protect us are too large or they are placed in a wrong place. The International Monetary Fund, the World Bank and the other so-called Bretton Woods institutions, need to be reformed. The churches have been pleading for this over the last fifty years. Now is the time to strengthen the multilateral system with a common effort to reform existing institutions into new authorities. Something is brewing: senior bankers gathering together in the offices of the Deutsche Bank in Frankfurt to talk with a cardinal and with theologians about how, what and by which path; CEOs of a number of multinationals like Paul Polman of Unilever meet with archbishop Nichols in the archiepiscopal palace of Westminster to talk about necessary changes; in the Vatican itself, world famous economists and politicians gather with leaders from international financial institutions and with bishops. The time is ripe, act now!, it spells. And now I am going to say something imprudent. If the new Pope refers to the obsession in his church about abortion, con-
traception, gay rights and so on, is that not a sign for the American bishops that says: speak up about the environment, poverty, capitalism and inequality. Use your influence in these matters too, just as you did thirty years ago. And don’t just complain about wrongdoing, but give direction: Tell people that until we have drastic international reforms, those predators, that sometimes tiny elite, will continue to prey with impunity upon many hundreds of millions of fellow citizens. The principles of the Christian social tradition of solidarity and subsidiarity point in just one direction: The fact that nowadays our people are joined by common interests around the world, calls for a safety-net without borders for the poor, and—at the same time—for institutions and regulations with global authority. It even calls for an abolition of the privileged status of financial transactions ranking above the trade in goods and services—the start, thus, of cross-border taxation, something like the Tobin Tax.

But indeed, we cannot realise all this without tackling the global infection with greed and the prevalence of self-interest. At the conference of the Deutsche Bank, a senior executive of Goldman Sachs said: “In the end all regulations are futile. Escape routes are already figured out by my staff even before the ink has dried.” These regulations will only be effective if they are supported by an ethical change, and an ethical and moral revival. This should start with the individual banker, but also on a collective basis in institutions, in the economy, in enterprises, in politics. That is easy to say, but what kind of ethics, what kind of morality do we need, and most of all, what are our sources of inspiration?

Adam Smith could defend a free market with his invisible hand making corrections, because he started from the general acceptance of Christian ethics and the belief in an almighty God. But in a culture which does not share a common inspiration, how do we arrive at an idea of the general interest, without any sanction lurking around the corner. How do we return to the idea that was expressed in The Perfect Prey by a former Dutch top banker, decent in an old-fashioned way: “If you want to get rich in a quick way, don’t get yourself a job in a bank.”

There are examples where, beyond religious and anti-religious traditions, an almost global consensus grew regarding what is right and what is not. Child labour, discrimination, respect for a number of basic rights: different domains in which humanity has made a tremendous progress after 1945 and 1989. Sure there are still gaps and relapses, but still. The key question for the coming years is whether the relation between money and goods, according to some people between money and God, will be restored. Because that is what Lord Brian Griffiths of Goldman Sachs admits wholeheartedly: if we don’t restore this combination of individual and collective morality, then anything we invent will be futile, whether it concerns new taxes or larger reserve funds, abolition of bonuses or international control.
Our own responsibility

There are four sides to that inconvenient, yet apparently inherent relation between capitalism and inequality. There are always winners and losers on the market. That is the inevitable part of the game. But how high can the profit be and how low the loss?

The core of the approach in this story is that the question of capitalism and inequality in the second decade of this century is neither a confusing mess, nor a simple uniformity; rather, we see four different segments:

« Firstly, the bottom 10 to 20 percent that is reduced to, or locked in, severe poverty, in extreme inequality of income and possession, coupled with the absence of opportunities.

« Secondly, the values and interests which are not included in the balance of profit and loss of enterprises and entrepreneurs, i.e. environment, human rights, consumers’ interests, sometimes quality, production and trade in illegal products.

« Thirdly, a shrinking and declining middle class, including young people just arriving on the labour market, the pensioners with their shrinking income, small businesses being competed out of the market.

« And finally, the upper class for whom ‘the winner takes it all’ applies, who seem to have no limits to their income and profit growth, no borders, nor—in some cases—ethical boundaries.

If we examine these four dimensions of change in the balance of profit and loss in our global market system, our top priority should be to do something about the biggest losers: the bottom billion people. It is essential that they get more equal opportunities, opportunities to escape from that one or two dollar yoke. It is possible. It has been proven and the success of the immense effort to achieve the goals as described in the Millennium Development Goals was so big in the past few years, that we should stick to this approach. This was also stated in the report A New Global Partnership, presented by the Secretary-General of the UN only recently with the significant under title “Eradicate Poverty and Transform Economy”. It contains a double message that applies also to this subject: provide aid for the time being, for this has proven to be very successful. But at the same time we need a structural transformation of the economy, giving opportunities to the poorest.

One of the biggest, yet rather successful distortions of the truth is that aid is wasted money. In a time that we need to cut expenses it is of course a comfortable message. But those that say that we certainly need to continue with this proven successful approach, are not just anybody and surely not some unworldly idealists—for example David Cameron or Paul Polman, the CEO of Unilever. Money for education, care, water and a basic income to feed the children and repair the leaks in the roof is not wasted.
But more interesting is what is happening in the UK. Churches over there are not only investing in food banks but also in micro-credits. They do so in close cooperation with schools! A growing number of secondary schools, together with the parishes they belong to, are running loan-programmes for people from the neighbourhood. These loans last for a day, a week, a month perhaps, so that these people won’t become victim of the so-called payday loans or usurers. Added to this is that it confirms their dignity because they are known by their name. It has a unique educational dimension: pupils of 13 or 14 years get into contact with another kind of reality than consumption, fashion, chatting and chilling. Their class room is turned into a little bank where they are introduced to poverty, survival and other things from daily life. To end the actual segregation in which an important part of our youth grows up, should be given much more attention.

The second adjustment concerns the vulnerable and the defenceless, ranging from the environment to human rights. In these matters too, we as ordinary citizens get involved. There is increasing consumers’ awareness. Every purchase is a choice, a statement for myself, for my surrounding, for the seller and for the production. The power of the organised and non-organised consumer is enormous. Buyer strikes are a negative instrument; but preferences can also lead to positive choices: fair trade products, products free of child labour and manufactured in decent labour conditions, products with a green label. Also in the way we behave financially we can contribute, for example by investing our money in green and ethical investment funds. It all starts with ourselves.

Let’s go back to England again. The Anglican Church under the leadership of archbishop Justin Welby, a late vocation of someone that used to be in the oil and banking businesses, goes a step further. With 8 billion pounds in the church’s pension fund and deposits of thousands of parishes, they are an important financial player. They use their influence for an activating policy. On their shareholders’ meeting they think about the relation between performance and bonuses. How could the Libor scandal take place? Why aren’t there more alternative investments? What matters is fulfilling legal and ethical conditions, and many are surprised by the response and especially the coalitions with other big shareholders and investment funds.

Thirdly, there is the middle class with shrinking financial strength, whose children are confronted with unemployment and forced to work longer for an equal or even reduced income. In the US the situation is perhaps more extreme, but also in Europe underlying tendencies evolve in the same direction. What do we do about it? Can we do something about it? The political debate of today: acceptance of globalization or denial and escapism?

From the summits of capitalism is said that the Christian social Rhineland model or the mild social-democratic Scandinavian model could be an attractive alternative. We must therefore ‘capitalise’ on that! There is no way back to 1989 for example, the time when the Anglo-Saxon model had won. Neither can we return to the certainties and protection of the 1980 welfare state.
When one says that it is about values such as justice and solidarity, that it is about responsibilities and the use of talents, one gets another outcome. When one is attached to values of Christian social inspiration and at the same time realises that the execution depends on place and time, one knows that a transformation is needed.

In the Christian social movement we should also discuss things that make us competitive. We should think about ways to use our talents, how to combine saving and productive investment, how to realise a truly responsible entrepreneurship. Christian social conduct should again be equal to modernisation, dialogue, and, yes, dare to take up an active middle position. We should not get stuck in 1960 or 1980 and cling to acquired rights, mainly serving our own interests. Globalization and sustainability are challenges and opportunities, just as once the movement’s acceptance of industrialisation and modernisation kept the movement relevant for the people involved and for the whole of society.

What we need to do is build a new socio-economic and ecological market model. That can have a promising future, locally and globally, but we will have to re-invent it, implement and promote it.

Crucially, will we have the courage and the vision to adequately involve the global financial system, and therewith the excesses of the top incomes and fortunes. Perhaps due to its technical complexity, perhaps also because we feel powerless, there is hardly any pragmatic debate or translation of our values into a new global structure. We don’t seem to get any further than saying that bonuses should be abolished.

Even when it becomes blatantly obvious that extreme differences in income in the long run will cause serious social and political disruptions, the persistent misunderstanding remains that if someone’s income is less, another one will have more. What is at stake is a complete architecture of a new participatory globalization, not a threatening globalization but one that offers perspectives. This is meant for the poorest in foreign countries and for the group that lags behind or drops out in our own society. The top floor of that globalization building should be the home for a new financial and banking regulation. That regulation will be global, or it will be nothing. There will be no room for tax paradises or a rat-race of deregulation between the different countries fighting for the biggest possible piece of the pie in the global bank sector. There should be room for global guarantee and safety-net systems. We should discuss on the possibilities and impossibilities of imposing taxes on financial transactions. Voices from various sources and places we hear: Finance, a Christian reflection on the matter, is the title of a book from Pierre de Lauzun, who is Deputy Director general of the French Banking Federation (FBF). In Germany, the book Das Kapital, written by Reinhard Marx, archbishop in Munich, has become the best-seller on the list of Der Spiegel. And on several places in Europe entrepreneurs, bankers and theologians come together and think about the demand for a new financial structure.

And there is a need for this too, because we still have that other question of
Lord Brian Griffith of Goldman Sachs. How do we get the new combination of individual and collective, institutional ethics? His answer is clear: Churches, religiously inspired movements, ideological movements and think-tanks should not hesitate to reflect on these questions and debate the answers. They already do this on so many other topics, but please give this dimension of capitalism and inequality attention. Regulations, a separation of functions, the abolition of bonuses and an increase of reserve funds, they are altogether only half of the solution. The critically important revival of public confidence is only possible if we start from another culture, one of service and a heightened ethical awareness.

There was the appeal in the early fifties to reach for peace, reconciliation and mutual solidarity in Europe, and eventually to realise these in super-national institutions. Perhaps we are once more at such a crossroads where we should link the reality of globalization with forms of multilateral authority and justice, founded on humanity, ethics, and values that recognize common welfare and the dignity of each individual as point of reference.

_Au travail!_
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