

The Financial Crisis and the Crisis of Conscience

by Michael Smith



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Adam Smith's *Wealth of Nations* is considered by many to justify the greed and self-interest which has led to the current financial crisis. On the contrary, as Michael Smith points out, Adam Smith considered it essential that capitalists behave with conscience, and his outlook may well have relevance to our predicament.

Never has a financial crisis had such a potential to affect so many people so quickly. As stock markets fell like dominoes around the world, the crisis has affected every one of us. As governments poured billions of dollars, pounds, euros and other currencies into supporting ailing banks, at taxpayers' expense, public sector borrowing has risen, without which there would be diminished resources to invest in hospitals, schools, public infrastructure, development aid, environmental and energy saving projects. And unemployment is rising, hitting families and communities.

Investors – from individuals and pension holders to charities – have suffered. Even the world's fastest growing economies, China and India are affected, despite huge trade surpluses and financial reserves. Growth in the world economy is taking a big hit and the IMF predicts a global

recession. As Dominique Moisi, author of the forthcoming book *The Geopolitics of Emotion*, wrote in *The Financial Times* (6 October 2008): 'When the rich become less rich, the poor tend to become even poorer.'

Never before has a financial crisis focussed so starkly on fundamental moral, ethical and spiritual issues. Words used by commentators include gambling and greed, dishonesty and fear, panic replacing confidence, risk and *hubris* versus prudence, and faith in the banking system or lack of it. Never have the values of trust and integrity been more needed in the global economy. The whole recent edifice of bank lending was built on maximising profit, an arguably dishonest assessment of individual borrowers' creditworthiness, and competitiveness between the banks in meeting shareholder demand.

US banks that invested heavily in the sub-prime mortgage market

did so knowing that many borrowers were not creditworthy and might have no way of meeting the interest, let alone the premium, on their loans. It was a house of cards waiting to collapse. As Christopher Hart, writing about such 'predatory' loans in *The Sunday Times* commented as long ago as last March (23 March 2008): 'The sub-prime crisis has arisen because the restraints on prudent behaviour broke down.... Some of the trades being made have been simply lunatic, with no conceivable rationale other than to ramp up the risk to create the chance of making a killing now.'

As soon as one US bank defaulted, other banks froze their intra-bank lending and liquidity in the markets seized up. There was an evaporation of trust between banks in their lending to one another. Where was the regulation? Where were the banks' auditors in the first place?

And what role could the banks' institutional investors, especially pension fund holders, have played in regulating risk in the demand for maximum returns?



■ Bradford & Bingley, who invested heavily in the properties-to-let market

Commenting on the dire economic situation facing President-elect Barack Obama — on the day of his historic election victory—Hamish McRae, the economics editor of *The Independent* (5 November 2008), wrote about the role of the individual in exacerbating the financial crisis: 'If the country as a whole has been unwise so too have many individuals within it. One of the startling revelations of the past few months is the way in which Americans with no income, no assets and no credit record have been able to borrow money from the banking system. Those loans are now going sour and you can argue whether this was principally the fault of the borrower or the lender. You cannot however argue that it is a great idea for families not to have any savings.'

The same could be said of the UK. Here, thanks to deregulation in the financial markets, building societies converted to banks and

became driven by the profit motive rather than by prudence. One bank, the Bradford and Bingley (based in the city of my birth), invested heavily in the properties-to-let market through what became known as 'liar loans'. Individual borrowers could exaggerate their earnings, no questions asked, and needed no proof of their creditworthiness or collateral. It was fundamentally dishonest and was bound to end in tears.

Despite the pain, it may all be healthy in the long run. For the financial crisis is a chance to re-examine fundamental motives; and to ask how the capitalist system at its best is supposed to work. Where is our faith placed? Is it in markets, profit and the capitalist system, or in something deeper? Of course we all want our finances, including our pensions, to be in safe havens. We try to find the best returns on our assets. We move money around. Indeed there is a biblical precedent in Jesus' parable of the investment and return on 'talents'. The one whose 'talents' increased the most was most praised. The one who buried his talent in the ground (under the mattress?) was most condemned¹.

But those who are driven solely by the profit motive and 'the love of money', described by St Paul as 'the root of all evil' (1 Timothy 6:10), are now discovering that security placed in material wealth is an illusion. A curious weakness of human nature says that the more we have the more we seem to want that little bit more. When Rockefeller was asked 'How much is enough?' he is said to have replied, 'Just a little more'. Yet the

roots of security and satisfaction lie elsewhere, certainly not in maximising wealth so much as in the search for the divine purpose for our lives.

Entrepreneurs and others who have won vast fortunes and then lost them, whether through their own misjudgments or that of others, know what it is like to have to recover and rebuild. My father and his generation of our family lost their wool textile business through an opportunistic take-over — and some unwise investment decisions. He had to create a new life. The vast majority of us, in less dramatic circumstances, can know that there is security in the knowledge of a divine plan that shapes our days, 'rough-hew them how we will'². We may not escape downturns, even disasters. But we can also live in the knowledge that we are all loved by the divine Creator —



■ Tiffany stained-glass window of St. Augustine, Lightner Museum, St. Augustine, Florida. (Detail)

even if he sometimes despairs at our folly granted by our free will. My father found serenity in his latter years despite reduced family circumstances. As Augustine, the North African saint who had lived a wild life in his youth, stated: 'Our hearts are restless till they find their rest in Thee'³

Meanwhile the excesses of the market have called into question the whole capitalist system itself. Karl Marx's *Das Capital* has flown off bookshelves. Yet it is ironic, as



■ Marx & Engels at their monument in East Berlin ■

Philip Collins pointed out in *The Times* (21 October 2008) that Marx wrote his text condemning capitalism 'while living off its charity'—that of his friend and collaborator, the Manchester mill owner Friedrich Engels. 'If it hadn't been for Engels,' Collins wrote, 'Marx would never have finished the book. In fact, if it hadn't been for Engels, Marx would never have finished his evening meal.'

So how can capitalism be rescued from itself? To answer that question, we can turn not to Marx but to the father of capitalism himself. Adam Smith was the Chair of Moral Philosophy at Glasgow University, 1752-1764, which, he said, was 'by far the most useful and therefore by far the happiest and most honourable period' of his life. As Ambassador Archie Mackenzie reminds us in his book, *Faith in Diplomacy* (2002), Adam Smith wrote *The Theory of Moral Sentiments* in 1759, 17 years

before he published his seminal tome on capitalism, *The Wealth of Nations*.

In the first book he referred to 'the Impartial Spectator' inside each of us which acted like 'a demi-god within the breast'. It was 'there to speak for itself *and for others*'. And 'in the race for wealth, if injustice is done, the Impartial Spectator changes sides'. In other words, greed and the profit motive could not be condoned if they led to injustice. There were fundamental moral principles at stake. 'To restrain our selfish, and to indulge our benevolent, affections constitutes the perfection of human nature,' Smith wrote.

Moreover, he described the 'man within us' – in today's language the conscience – as 'the Vice-Regent of the Deity' and we needed to 'co-operate with the Deity and advance, as far as in our power, the plan of Providence'.

So did Adam Smith recant on his moral philosophy in *The Wealth of Nations*, published in 1776 (the year of America's independence), 12 years after he had stepped down as Chair of Moral Philosophy? Did his second book, as an economic treatise, only advocate the pursuit of self-interest? Not necessarily. In Book 1, Chapter 9 of *The Wealth of Nations*, he states: 'Our merchants and master-manufacturers complain much of the bad effects of high wages in raising the price, and thereby lessening the

sale of their goods both at home and abroad. They say nothing concerning the bad effects of high profits. They are silent with regard to the pernicious effects of their own gains. They complain only of those of other people.' Here Smith was arguing for a restriction on profit and greed among employers—limiting the maximization of profit—in favour of paying higher wages, so as to enrich the whole of society.

We can surmise, given Smith's view on his 'most honourable' time as Chair of Moral



■ Adam Smith ■

Philosophy, that he may have also regarded his first book as being equally honourable as his second book, and even of major significance. As Stephen Young, Executive Director of the Caux Round Table group of business executives, argues in his book *Moral Capitalism*, subtitled *Reconciling private interest with the public good* (2003), the separation of Smith's two texts has given us

a distorted notion of how capitalism should work.

The American anti-corruption author Raymond Baker, a leading authority on money laundering, who is a Senior Fellow at the Center for International Policy in Washington DC, concurs. In his book *Capitalism's Achilles' Heel*, subtitled *Dirty money and how to renew the free market system*, (John Wiley, 2005), he writes (chapter eight): 'It is the functioning of man in society, in communication with his fellow man, evolving through "habit and experience" an ever-widening archive of moral sensitivities and convictions that constitutes the driving force in his [Smith's] ethical system.... *Moral Sentiments* is filled, page after page, with Smith's view of the "amiable virtues" befitting men of character... These are the people, people of sincerity and sympathy, that he envisioned

would operate the free-market system he laid out in *Wealth of Nations*, the second of his great contributions to Enlightenment thought and to the centuries that followed.'

Capitalism, we can conclude, could not be separated, even in Adam Smith's view, from conscience and indeed the possibility of a divine providence, a guiding hand. For without conscience, without let us say the 'invisible hand' of divine grace, untamed capitalism too easily leads to corruption and greed, a loss of common sense and common humanity. It could even be argued that 'boom and bust' is the inevitable consequence of the failure of personal self-regulation, as much as fiscal regulation through law—a failure of judgment which leads to the swing of the pendulum towards the excesses of greed and imprudent risk-taking.

To rescue capitalism and the banking system, we need to revisit Adam Smith's moral philosophy—and our own consciences. ■

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An earlier, much abbreviated version of this article appeared in Times Credo column, page 83, on November 8. See <http://www.timesonline.co.uk/tol/comment/faith/article5109991.ece>

Notes

- 1 'See Peter Heslam's comment on the parable of the talents in 'Thrift as Solution to the Credit Crisis', FiBQ 12:1, pp.33-34.
- 2 'There's a divinity that shapes our ends, Rough-hew them how we will...', William Shakespeare, *Hamlet*, Act V Scene 2.
- 3 St Augustine, *Confessions*, I:1.

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