

Richard Higginson

interviews

Brian Griffiths



Brian Griffiths, Lord Griffiths of Fforestfach, is a Vice-Chairman of Goldman Sachs International. He is a high profile Christian operating at the top of the banking profession. He kindly agreed to give an interview for Faith in Business Quarterly at Goldman Sachs' Fleet Street office.

The financial crisis of 2007-9 seemed for a time to threaten the very future of capitalism. How do you think the global economic order now appears?

At the time of the crisis a lot of people were suggesting it was the death-knell of capitalism – people like President Sarkozy and the Roman Catholic Archbishop Murphy-O'Connor. The Financial Times ran a series: 'Can capitalism survive?' Since then worldwide it's been a tale of two halves: the rapid growth of the emerging markets and much lower growth in the countries most affected by the crisis, even though they have bounced back remarkably well. In the UK the Government was critical to the recovery, stepping in and bailing out the banks. As tax revenue fell it allowed Government spending to continue, and so the government deficit rose. Meanwhile the central banks pumped billions of liquidity into the economy. This was decisive action and I believe Alistair Darling took the right measures.

Since then in the UK we've seen the resilience of a market economy with recovery being led by investment and exports. The new Chancellor George Osborne was right to take decisive action and implement radical measures; his plan to curb spending, increase taxes and reduce the budget over the course of this parliament restored confidence. Until that budget, confidence in the pound and the ability of the government to borrow were very shaky. The measures that the Government are taking are tough but

necessary, namely exerting fiscal discipline and not letting inflation get out of control.

What attitude would you like to see the churches taking towards capitalism?

By and large the churches tend to have a rather negative attitude towards capitalism. They are obsessed with wealth redistribution rather than wealth creation, though they are delighted to take the fruits of wealth creation when the collection plate is passed round! I would like to see the churches showing more enthusiasm for wealth creation. Wealth creation is important not just for families but for the proper provision of public services and welfare payments. There is still in this country a strong sacred-secular divide: many people I talk to in the business community feel that the clergy don't really understand where they are or what they're doing.

I wanted to ask you about the attitude of young Christians bankers today...

I find that many young Christians in the City do see what they do in terms of their Christian vocation: contributing to the common good, helping the world economy to grow, providing infrastructure for world trade and global investment. Yes, I know many young Christian bankers with this attitude. I am impressed by people in their 20s, with how concerned they are to see what they do is within an ethical framework. ▶▶

►► I should also say that I'm equally impressed by Jews and Muslims of the same age who take their faith seriously and have high ethical standards.

All the same, the banking sector has come under an intense critical spotlight over the last couple of years. As a high-profile Christian who works at the very heart of banking, how do you feel about this? Have you felt personally under attack?

It's been a very tough few years. Some criticisms of the banking system were clearly justified. The crisis showed that the system was under-capitalised; that banks didn't value their assets at market prices; some made very bad lending decisions; the compensation structures of several banks rewarded short-term risk-taking. Certain products were exceptionally complex and difficult for investors to understand, let alone the non-executive directors of banks.

$$(f+g)'(x) = f'(x) + g'(x)$$

proof from book:

$$(f+g)'(x) = \lim_{h \rightarrow 0} \frac{(f+g)(x+h) - (f+g)(x)}{h}$$

$$\rightarrow = \lim_{h \rightarrow 0} \frac{[f(x+h) + g(x+h)] - [f(x) + g(x)]}{h}$$

$$\rightarrow = \lim_{h \rightarrow 0} \frac{[f(x+h) - f(x)] + [g(x+h) - g(x)]}{h}$$

$$\rightarrow = \lim_{h \rightarrow 0} \frac{f(x+h) - f(x)}{h} + \lim_{h \rightarrow 0} \frac{g(x+h) - g(x)}{h}$$

how does this happen? why isn't $\lim_{h \rightarrow 0} \frac{f(x+h) - f(x)}{h}$ zero? $f(x) - f(x)$?

$$\rightarrow = f'(x) + g'(x)$$

Derivatives calculations

"Certain products were exceptionally complex and difficult for investors to understand, let alone the non-executive directors of banks"

The main case against the banks is, first, moral hazard – banks taking too much risk because they know they're too big to fail and, second, lack of competition. I think the nature and extent of competition in banking is best judged by the competition authorities. I do have concerns about concentration in retail

banking. Moral hazard is a reality and a hot topic of policy discussion. To deal with it we could separate banks into narrow or retail banks – banks simply for people who want safe deposits –and investment banks which take more risk. More likely is a requirement for all banks to hold greater equity capital and increase long-term funding. Already the banks on their own initiative are changing things, the regulators are reinforcing these changes, and in most countries the legislators are further reinforcing them as well.

While banks have been under attack since the crisis, we need to remember that before the crisis there were three decades of prosperity.



Shanghai, China, the scene of phenomenal growth. Three decades of prosperity lifted billions out of poverty

In China alone, for example, a few hundred million people were lifted out of extreme poverty. That is a remarkable achievement. There are other positive developments. There has been a high degree of innovation. In a competitive retail sector hundreds of different kinds of mortgages have been developed to meet the needs of borrowers. Foreign exchange markets for developing countries now have much greater breadth and depth than they used to. The development of credit default swaps make it easier to hedge and lay off risk for companies. All of these have been positive developments.

And the criticism that has been directed to you personally?

I've often asked myself the question, what could we have done differently? The last two



►► years have been a time for sober reflection. However I think the time has now come to draw a line in the sand on banker bashing. I believe since the crisis banks have looked at themselves critically. In my own firm, Goldman Sachs, we set up an enormous internal exercise, the Business Standards Committee, which has involved many of the partners of the firm, as well as outsiders, looking at every aspect of the firm to see how things could be done better.

Nevertheless, bankers have made themselves very unpopular by continuing to expect the payment of large bonuses, even when their financial institutions have been rescued by the Government. Why are bankers apparently so insensitive to public opinion? Isn't the justification that 'the market' demands these high rewards a convenient cop-out?

This is a difficult issue because if one opposes the public mood, one is assumed to be either greedy, lacking in compassion or having little sense of justice. My starting point is that the market economy is the best economic system we know if we want to create wealth, jobs, support innovation and meet consumer's needs. The labour market is a part of this system. If the market economy is to deliver these results then the labour market must be allowed to work.

Bankers' compensation must be seen in the context of globalisation. In the last few decades, capital controls were removed, tariffs reduced, state-owned industries were privatised and markets deregulated. Cartels in the financial sector, which were highly inefficient and kept charges high, were broken up. All of these changes were reinforced by developments in technology. The restructuring of capitalism in the latter part of the 20th century led to a dramatic increase in competition and through the fall of the Iron Curtain, the opening up of China and reforms in India, remarkable new investment opportunities soon appeared. The result of this has been that the differentials in pay between chief executives and average



Protests outside the Houses of Parliament against Bankers' Bonuses

skilled or blue-collar workers has increased in all markets and all countries, not just the financial sector and not just in London and Wall Street. What is distinctive about banking is that it is possible to measure fairly accurately the contribution made by an individual trader. If you don't pay the market rate you don't get the best people. It's as simple as that. London is in fierce competition with other financial centres like New York and Hong Kong – and the comparison is not just between financial packages but different tax regimes.

If compensation in banking is high because of moral hazard or a lack of competition or a structure of compensation that is too oriented towards short-term rewards, then compensation indeed may have been excessive. But all these things are being dealt with. Tackling moral hazard is high on the G20 agenda. The Independent Banking Commission in the UK is looking at competition. And already the structure of compensation to avoid short-term risk-taking is being tackled.

My personal view is that when all these problems have been dealt with, there might still remain a large global differential over pay within international business and banks which people will remain uneasy about. The very nature of a market economy will create differentials which certain people will always find unacceptable.



▶▶ Some say we need restraint. I believe restraint can work over a year or two but not for long. Any government's attempt to try and micro-manage banking compensation is, I believe, bound to fail. For the Christian the challenge for people who receive high rewards is what they do with them. In this regard St.Paul echoes the teaching of Jesus – the key is *generosity*, even on a personal level reckless generosity.

Has the net effect of the way that many banking processes like securitisation have developed been to eliminate the direct relationship between lender and borrower, with very harmful effects?

Securitisation actually started in the USA in the public sector, with Freddie Mac and Fannie Mae. In principle it's a good thing, an efficient use of capital. The selling of loans by the original lender is not unethical. With sub-prime lending however there was a separation between lender and borrower with harmful results. In the USA this was because the packages sold contained some really bad loans – “liars loans”, “NINJA” (no income, no



Bad loan
Vintage 1927 Spanish home in San Diego, California offered as a bank foreclosure in July 2008

job, no assets) loans, and “no doc” (documentation) loans. If these defects had been removed the system wouldn't have thrown up the same problems. In the US securitisation was accompanied by an

inadequate disclosure of information. I think there's also a good case that the original lender ought to retain some skin in the game – maintain some of the original loan - when the loan is sold on.

Bearing in mind what the Bible has to say about the charging of interest, the alternative models being promoted by Muslim banks, and the huge debts which are a burden to so many governments, institutions and individuals, do you think our economy needs to make a major shift from debt finance to equity finance?

We need to be clear about what the Bible says. It is not opposed to credit markets or to borrowing. The ‘no interest’ rule refers to people who were embedded within the Jewish economy. Lending to foreigners was allowed. The Old Testament is against the exploitative charging of interest in a small community. In the mortgage market today, for example, I believe it's reasonable for people to borrow to purchase a house over a few decades and pay back the loan with interest as a way of evening out their consumption over their lifetime.

However, there's no doubt that over the last ten years too much debt has been incurred in all areas of the economy. I chaired a commission a few years ago on the problem of debt for low-income families in the UK. Consumers had very high debt-to-income ratios, far higher than in continental Europe or the US. Banks have been over-leveraged with too much debt on their balance sheets. And even before the crisis, governments became hugely over-indebted. Debt has become a problem for governments, for the financial system and for individuals.

Going forward I believe we do need some rules in relation to debt. For government this is absolutely essential. 60% debt to GDP was until the crisis considered a good target. It is likely that there will be some rule on how



▶▶ much leverage banks can extend. Similarly with consumers, should lending institutions only maybe lend a maximum of say 80% of a value of a property? There is a need for clear and for greater transparency and sharing information between lenders.

I think the crucial difference is not so much between debt and equity as between private and public investment. With private equity, the equity holders are certainly more hands-on; they take more interest in the running of the company, even though the amount of debt incurred may still be high.



Lord Turner, Chairman of the Financial Services Authority

Lord Turner, the Chairman of the FSA, has described certain aspects of banking as ‘socially useless’. In a similar vein, the Windsor consultation on ethical finance which I co-chaired concluded that the financial services sector currently lacks a statement of social good. How do you respond to these views?

The statement that certain significant parts of the system are ‘socially useless’ is totally unwarranted. Certain aspects of banking are clearly useful – the provision of an infrastructure for payments or a channel into which people can place their savings, taking varieties of degrees of risk. But derivative markets also have social value. The ability of companies to hedge risk through futures and options markets as well as through credit derivatives is important for both companies and financial institutions.

But has the banking sector been poor at communicating these social goods?

Yes, that is certainly the case. I think there are some within banking who have made a good fist of it. But overall we have not have been very good at putting the argument across to the public that what we do is in the interests of society as a whole.

Goldman Sachs has been the subject of controversy in the last year or so for various reasons. Do you have any comment on recent charges and settlements?

Unfortunately the SEC and FSA settlements both include a provision that preclude any comment.

Has there been a significant shift of economic power from West to East? How crucial to the future of the world is the way that the relationship between China and the USA develops?

Undoubtedly, there’s been a huge shift from West to East. We see this in the different



Istanbul, Turkey

By 2050 Turkey is predicted to be in the top 10 world economies

growth rates between China, India, Brazil, Europe, the UK and the US. As well as Asia, growth rates have really picked up in Africa and countries such as Turkey. By 2050 Turkey is predicted to be in the top 10 world



▶▶ economies in terms of GDP; its growth rate this year is over 8% and it's spending a great deal on infrastructure and education. The East is both a challenge and an opportunity. And yes, the relationship between China and the USA is crucial. China could have moved faster in allowing its exchange rate to rise but this is not helped by America's policy of quantitative easing. The one thing above all others which must be avoided is greater protectionism.

Capitalism's dominant model is seen as the multi-national public limited company. Do you think there will be a rise in alternative business models, and should Christians be at the heart of such initiatives?

One of the strengths of capitalism is that it is open to all kinds of business models: private companies, public companies, social enterprises, credit unions. The key to global development is the growth of SMEs – small and medium-sized enterprises. The great challenge for the continent of Africa, for example, is to move from micro-finance to SMEs. I believe part of the aid given by DIFD, the Department for International Development, could do more in helping developing countries create an infrastructure for their own entrepreneurs to build SMEs.

Am I right in thinking that you are keen on social enterprise but less enthusiastic about fair trade? If so, why is that?

I really don't know enough about fair trade to comment, though I'm impressed by a recent booklet produced by the IEA (Institute of Economic Affairs), *Fair Trade without the Froth*. That seems to me to give a balanced account of fair trade, its achievements, but also its limitations. I am an enthusiast for social enterprise. This is about people investing in

developing countries but being prepared to accept returns less than they might receive through straightforward private equity. I am impressed particularly by Christian leaders such as Dr. Kim Tan, Stuart McGreevy and Mike Perreau who set up the Transformational Business Network, and who are investing their own money alongside many others in this way.

How do you assess the prospects for a sustained business recovery? What sort of Christian theology can help bring such a recovery about?

I am cautiously optimistic about the prospects for a sustained business recovery. If the government sticks to its medium term fiscal policy and keeps inflation under control we should see an export and investment led recovery over the next few years. Certainly that is the view of the Independent Office for Budget Responsibility. A recovery based on low inflation leading to lower taxes and taking account of welfare reforms will create a stronger economy. Christian theology has a great deal to say about the nature of the society which should accompany it.

Is there any final message you would like to give to readers of *Faith in Business Quarterly*?

Yes, first to recognise that Christians in business fulfil as important a calling or vocation as full-time clergy. There is nothing second-rate or inferior about starting or running a business which provides services, manufactures products and creates jobs. Next, the need to create within companies a culture based on sound values of integrity and service which recognises the contributions of all employees and our greater responsibilities. Finally the unfailing characteristic of Christians in positions of leadership should be to serve others, following the example of Jesus. ■

Lord Griffiths was appointed professor of Banking and International Finance at the City University in 1976 and was a director of the Bank of England from 1983 to 1985. He served as head of Mrs. Thatcher's Policy Unit from 1985 to 1990. He was responsible for domestic policy-making and was a chief architect of the privatisation and deregulation programmes. Since then, he has been vice chairman and international advisor to Goldman Sachs. He is Chairman of the Archbishop of Canterbury's Lambeth Fund and of Christian Responsibility in Public Affairs. He has written and lectured extensively on economic issues and the relationship of the Christian faith to politics and business, and has published various books on monetary policy and Christian ethics.

