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Market Exchange, Self-Interest, and the Common Good: Financial Crisis and Moral Economy

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The financial crisis of 2008–2009 presents us with the opportunity to not only understand what has happened in the markets but also to reflect on the purpose of the marketplace. Drawing from expert economic analyses, we first assess the central lesson of the crisis—the failure of self-regulation by rational self-interest to moderate externalized risk in financial markets. Second, we ask the philosophical question occasioned by the crisis concerning the moral meaning of economic activity: Is market exchange *solely* for the sake of self-interest? Reflecting on the poetry of Kahlil Gibran and engaging with the recent encyclical of Pope Benedict XVI, we turn our attention from political economy to moral economy: the relationships among market exchange, self-interest, and the common good—and, in particular, the prior conditions of market exchange and their moral significance for the present crisis.

The Central Lesson for Political Economy

The central problem of the financial crisis—as viewed from my philosopher's perspective, at least—is the failure of self-regulation by self-interest to moderate externalized risk in the financial system. Self-interested market actors—mortgage lenders, securities traders, investment bankers, and bond insurers—made risky investments on the assumption that the risk could be moderated by dispersal throughout the financial system. That assumption failed.

Risk-Management in Financial Markets

Mortgage lenders issuing sub-prime mortgages diverted the risk from their balance sheets by selling the loans on the secondary market. Investment banks buying sub-prime mortgages moderated the risk by securitizing them—bundling loans and dividing the bundles into a series of bonds. Securitizing sub-prime mortgages diluted the risk by spreading it among many investors. Investors leveraged their positions to purchase mortgage-backed securities and then hedged the risk by purchasing derivatives as insurance on their investments. These derivatives, which guaranteed the value of the securities in case the underlying loans went into default, transferred the risk from the security-holder to the derivative-issuer ("credit-default swaps"). This complex system of risk-dispersal by securitization provided the rationale for credit rating agencies to give the highest rating to securities backed by high-risk, sub-prime mortgages. In turn, the AAA rating provided the rationale for investment banks to sell those securities as safe investments, for investors to increase leverage to purchase those securities, for commercial banks to lend money to investors, and for insurance companies to swap the risk of default on those securities with investors.

In the older paradigm of finance and investment, from the Great Depression until the Greenspan era, tightly regulated, highly transparent institutions—commercial banks, savings banks, and insurance companies, backed and monitored by government guarantees and regulators—served as the "risk sink" in the financial system. This public system of financial regulation complemented the professional ethics of private actors: bankers, insurers, and lawyers did their work with a shared sense of public trust.[1] In the new paradigm of the Greenspan era, regulating agencies and self-regulating professions were replaced by self-interested investors and self-regulating markets. Loosely regulated securities markets were to moderate risk by dispersing it among private investors throughout the financial system. Unregulated derivative markets were to be the ultimate sink that would absorb the excess risk of increasing investment in sub-prime mortgages. Thus, Alan Greenspan could say to the Senate Banking Committee in 2003: "What we have found over the years in the marketplace is that derivatives have been an extraordinarily useful vehicle to transfer risk from those who shouldn't be taking it to those who are willing to and are capable of doing so." Furthermore, Greenspan was confident at a Congressional hearing in 2000 that because excess risk had been "sunk" into the derivative markets, the financial markets were sufficiently buffered from systemic crisis: "I believe that the general growth in large institutions have occurred in the context of an underlying structure of markets in which many of the larger risks are dramatically—I should say, fully—hedged."[2]

Banking on a fundamental faith in financial markets, Greenspan consistently resisted government regulation of derivatives during his tenure at the Federal Reserve.[3]

Self-Regulation by Self-Interest

The operative theory of this complex system of risk management in financial markets was to be neither bureaucratic oversight nor professional ethics but self-regulation by self-interest: investors and institutions, acting on rational self-interest would not expose themselves or their shareholders to excessive risk. Yet, the enticing prospect of quick profits from inflated values in the housing market, enabled by easy access to cheap credit and foreign capital, did lead a range of rationally self-interested actors—from mortgage lenders to securities traders to investment bankers to insurance companies—to do just what the adherents of the theory of rational self-interest said they would not do.[4] For, as long as housing prices continued rising, each independent actor—those who originated and bought sub-prime mortgages, those who sold and bought mortgage-backed securities, and those who insured the securities with derivatives—could serve (short-term) self-interest through investment in sub-prime mortgages. With the burst of the housing bubble and the consequent wave of mortgage defaults, securities issuers and insurers alike were left unable to make good on their obligations, investors in turn were left unable to sell off their securities and repay their loans, leaving shareholders and creditors to absorb losses. With all that, the entire structure of risk management in financial markets came undone.

Greenspan was thus compelled to confess before Congress:

> those of us who have looked to the self-interest of lending institutions to protect shareholder's equity (myself especially) are in a state of shocked disbelief. Such counterparty surveillance is a central pillar of our financial markets' state of balance. If it fails, as occurred this year, market stability is undermined…
>
> … This modern risk management paradigm held sway for decades. The whole intellectual edifice, however, collapsed in the summer of last year…[5]

What explains this collapse? Greenspan himself faults market models: inadequate input data led to "the failure to properly price such risky assets that precipitated the crisis."

Greenspan notwithstanding, other economic analysts point to the underlying theory of risk management. The problems with theoretical models of financial markets were more extensive and serious than simply inadequate input data.[6] The problem goes to the basis of the models. Theoretical models for gauging risk and pricing assets guaranteed risk moderation in financial markets on the premise that market actors would not generate excessive risk due to rational self-interest: "every investor," it was assumed, "rationally balances risk against reward."[7] The current crisis is evidence enough of the failure of that assumption. Rational self-interest has proved to be an insufficient (but not irrelevant) mechanism for regulating risk in financial markets: the "intellectual edifice" of self-regulation by self-interest has collapsed upon itself.[8]

This central lesson of the financial crisis can be understood by way of a limited and imperfect but useful analogy between financial risk and industrial pollution:

> the notion of "externality"—a cost or a benefit to society that is not captured in the price of private transaction—is one of the keys to understanding market failure. It makes sense to regulate pollution—from a free-market economic perspective—because society is bearing the cost of pollution strewn into the atmosphere. The most important externality we now need to confront is risk.[9]

This analogy might be elaborated: A century ago unregulated industries operated on the assumption that pollution could be externalized into the environment at minimal risk of harmful effect by dumping it into waterways or emitting it into the air stream: "The solution to pollution is dilution" was the conventional wisdom. The repeated experience of the last century has proved that conventional wisdom to be unsound. The present financial crisis teaches us that, just as ecosystems have limited capacity to absorb pollution before ecological balance is destroyed, so financial markets have limited capacity to absorb risk before economic balance is destroyed.

This analogy motivates the following argument: Investors (analogy: manufacturers), each of whom acts rationally and independently to maximize individual profit, have limited self-interest in moderating risk (analogy: controlling pollution) as long as the risk of investments (analogy: pollution) can be transferred into and dispersed throughout the market (analogy: diluted into the environment) without incurring harm to oneself by a negative feedback loop. Indeed, far from generating negative feedback, the securities market for sub-prime mortgages incentivized risk, as mortgage brokers, originators, securitizers, and "derivatizers" all profited from increasing demand for mortgage-backed securities. Market incentives from the secondary market for securitizing mortgages, operating on the rational self-interest of brokers and lenders, clearly drove the origination of sub-prime mortgages.[10] Indeed, many loosely regulated mortgage lenders originated sub-prime mortgages with the sole intent to sell those loans for securitization ("originate to distribute" lending). That securitization incentivized rather than moderated risky lending practices is a point that Greenspan himself conceded before Congress in 2008: "The evidence strongly suggests that without the excess demand from securitizers, sub-prime mortgage originations (undeniably the original source of the crisis) would have been far smaller and defaults accordingly far fewer."[11]

Under the prevailing market conditions, which not only allowed for risk to be transacted from risk-generators to risk-takers—diluted into the investment stream by securitization of mortgages and derivatives on securities—also afforded incentives for risk generators to siphon profits from this investment stream. It was rational in terms of self-interest for independent actors to broker, originate, securitize, and derivatize sub-prime mortgages despite the greater risk externalized to the financial system. Thus, Paul Krugman, the Princeton economist said:

> Why did bankers take on so much risk? Because it was in their interest to do so. By increasing leverage—that is, by making risky investments with borrowed money—banks could increase their short-term profits. And these short-term profits, in turn, were reflected in immense personal bonuses. If the concentration of risk in the banking sector increased the dagger of a systemwide financial crisis, well, that wasn't the bankers' problem.[12]

What made this self-interested financial risk-taking both possible and profitable were complex financial instruments. Again, Krugman, on securitization: "Above all, the key promise of securitization—that it would make the financial system more robust by spreading risk more widely—turned out to be a lie. Banks used securitization to increase their risk, not reduce it, and in the process they made the economy more, not less, vulnerable to financial disruption."[13]

Similarly, on derivatives, Janet Tavakoli, investment consultant and former professor at the University of Chicago's Graduate School of Business, states that derivatives have "added to the risk in the system by providing leverage and providing opacity."[14]

Systemic Risk in Financial Markets

The cause of the financial crisis cannot be summed up by the self-interested risk-taking of investors and institutions, however. It is not solely the risk-taking of individuals but the interdependence of risks as well as the opacity of that interdependence that precipitated the crisis. Economist Martin Hellwig of the Max Planck Institute states:

> If the crisis was just the result of greed and recklessness, it would be enough for regulatory reform to focus on risk incentives and risk control.… Systemic interdependence has also played an important role. Moreover, participants did not know the extent to which systemic interdependence exposed them to

> risks. Risk taking that, with hindsight, must be considered excessive was not just a result of recklessness, but also a result of an insufficient understanding and of insufficient information about systemic risk exposure.[15]

While securitization and derivatives were intended to moderate risk by dispersing it, risk dispersion did not eliminate risk *correlation*; the complexity and opacity of such investment instruments obscured the interdependence of risks. A. Michael Spence, the Stanford economist explains:

> There are two striking aspects of the current crisis and its origins. One is that systemic risk built steadily in the system. The second is that this buildup went either unnoticed or was not acted upon. That means that it was not perceived by the majority of participants until it was too late. Financial innovation, intended to redistribute and reduce risk, appears mainly to have hidden it from view.[16]

We can understand this aspect of the financial crisis by considering our analogy again. The individual pollution producer, as an isolated actor, cannot see how the pollution he emits will interact with the pollution emitted by others—and thus cannot anticipate how accumulated pollution in the ecosystem, due to a complex web of causal links, might threaten his own interests. Likewise, investors, calculating risk as individual actors, could not see how the correlation of risks generated by independent decisions would affect the entire market—and thus could not predict that correlated risk in the financial system might threaten their own interests. In financial crises, unseen links due to similar exposures among different actors result in correlations between leveraged positions that were apparently independent.[17] Consequently, institutions with sound investments in one market go down along with institutions having failing investments in another market because of similar exposures in a third market—and, in this case, ordinary shareholders in the stock market and responsible borrowers in the housing market consequently go down along with high-risk speculators in the securities and derivatives markets.

Market-based risk management by means of securitization and derivatives, based on the theory of self-regulation by rational self-interest, not only failed to prevent systemically unsustainable risk but instead magnified and disguised the problem. Rationally self-interested actors took advantage of securitization and derivatives to increase risk by increasing leverage in order to maximize profits. In turn, this self-interested, risk-generating activity of some actors consequently exposed many actors to higher risks through unseen links. The problem, then, goes much deeper than Greenspan was willing to admit.[18] Just as the mounting problem of environmental pollution in a complex, highly integrated ecological system cannot be dealt with at the level of individual self-interested polluters, so the mounting problem of correlated risk in complex, highly integrated financial markets cannot be dealt with at the level of independent self-interested investors and institutions. It can be argued, therefore, that prudent regulation of both self-interest and systemic risk in financial markets is necessary and justified.[19]

The Deeper Question of Moral Economy

Is this the only, or even the most important, lesson to be learned from the financial crisis? Constraining the excesses of self-interest and taking systemic risk into account does not require a fundamental rethinking of economic life. The libertarian proponent of the theory of rational self-interest might simply acknowledge systemic risk as an unavoidable factor in the calculus of self-interest and merely concede that government regulation of systemic risk is the necessary means to establishing the market conditions in which self-interest can be rationally pursued with the greatest advantage.

Yet, systemic risk affects not only individual interests but also the common good. The financial crisis has not only frustrated the fortunes of financiers but has also unfairly imposed the cost of failure on many who had not bet their own financial houses on the sub-prime market. To stave off economic calamity, Washington has guaranteed Wall Street with capital, leaving retirement investors, responsible homeowners, and future generations to pay for the excesses of the executives through devalued funds, foreclosed homes, and public debt. The public stakeholders in financial markets go well beyond, and far outnumber, the private stockholders in Wall Street.

Regulatory reform in financial markets, though necessary and justified, does not by itself get to the heart of the matter evoked by the financial crisis. The present crisis prompts us to rethink our economic life, to ask the deeper question of what an economy is *for*. As Pope Benedict XVI has stated in his recent encyclical, "the human consequences of current tendencies toward a short-term economy—sometimes very short-term—need to be carefully evaluated. This requires *further and deeper reflection on the meaning of the economy and its goals*."[20] This crisis thus presents us with the opportunity to shift our attention from the nature of *political* economy to the nature of *moral* economy, the moral reality that underlies economic activity.[21]

Rational self-interest, and the freedom to pursue it, are insufficient for thinking soundly about economic activity, not only because of systemic risk in financial markets but more so because this way of thinking has forgotten the fact that the market itself is a moral reality. The marketplace is not a value-neutral space, defined only by the interacting interests of independent individuals. The market, in order to function properly, depends on values that the market itself cannot generate. Two prior conditions are necessary for there to be a free and rational exchange between self-interested traders.

The Practical Corollary of Market Exchange

The first condition of market exchange is moral. The free play of self-interest in the market, as even Adam Smith recognized, banks on trust: although buyers and sellers, borrowers and lenders alike act on self-interest, if there is no trust between traders, there is no market for trade.[22] This trust between traders, however, neither is derived from the exchange of goods nor is a good to be traded. Pope Benedict writes: "In fact, if the market is governed solely by the principle of the equivalence in value of exchanged goods, it cannot produce the social cohesion that it requires in order to function well. *Without internal forms of solidarity and mutual trust, the market cannot completely fulfill its proper economic function*."[23]

Rather, the exchange value of goods depends on trust, and the trust that underpins values derives from the mutual trustworthiness of market traders. As Smith observed, the paper promises issued by a trusted bank (e.g., notes or bonds) are practically equivalent to currency and can be easily exchanged for goods in the market.[24]

However, when mutual trustworthiness is absent, the value of paper promises—say, mortgage-backed securities and derivatives—becomes uncertain, the market for trading in such promises freezes, and investors are left holding portfolios of worthless paper. The flow of credit between lender and borrower and the exchange of goods between seller and buyer is disrupted. Insofar as the liquidity of assets is a function of trust between traders, a deficit of trust in the marketplace undercuts the freedom of exchange even when the cost of investment (interest rate) is cut nearly to zero—which was precisely the situation in the financial crisis.[25] Excessive self-interest has impeded market exchange by undermining trust.[26] The moral constraint of self-interest is thus a necessary corequisite of a functional market. Virtue—here, trustworthiness—is thus prior to the free pursuit of rational self-interest in the marketplace.

Trust, moreover, correlates to transparency. Judging the risk-worthiness of an investment depends (in part) on judging the trustworthiness of the party promising returns, and judging the trustworthiness of a counterparty requires knowing that party's position in the market. Rational trust in the promissory notes issued by a certain bank, to continue with Smith's example, depends on the degree to which one can make an informed judgment concerning that bank's solvency.

Trade, then, depends on trust, which in turn depends on transparency: no trust, no trade; no transparency, no trust.

A key element in the freezing of financial markets has been the lack of transparency among counterparty institutions and that lack of transparency is due largely, by design, to the deregulation of derivatives. One way an investor or creditor might judge the market position of a financial institution that issues an investment instrument is to consider to what degree that institution has hedged the risk of its own leveraged position or exposed itself to the risk of another's leveraged position with derivatives. Without regulatory requirements for reporting on derivative contracts, counterparty positions have been left opaque, and this opacity has increased uncertainty over asset prices, resulting in reluctance to buy securities from or lend money to institutions whose positions are suspect.[27] Although done to promote market freedom on the premise of self-interest, deregulation has undone counterparty transparency, a prior condition of rational exchange and, thereby, has undercut market freedom. Again, virtue is prior to freedom and self-interest; freedom without virtue is destructive of self-interest.

The Fundamental Fact of Human Economy

The second condition of market exchange is material—and, implicitly, theological. A free and rational exchange of values between self-interested traders can exist only because the basic goods necessary for producing values through labor have been provided already through nature. Creation, therefore, is the essential presupposition of all production and trade. From a theological perspective, the objective reality of divine creativity—the original source of the common store of nature's goods—is the beginning point of economic activity: human economy is impossible apart from divine grace dispensed through created goods. The market, therefore, has a divinely ordained, essentially moral purpose: the freedom of exchange is meant, not for the pursuit of self-interest alone and above all but to serve the common need of God's creatures.

This truth is brought forth beautifully in *The Prophet*, the masterpiece of the Maronite-Catholic poet Kahlil Gibran:

> *And a merchant said, Speak to us of Buying and Selling.*
> *And he answered and said:*
> *To you the earth yields her fruit, and you shall not want if you but know how to fill your hands.*
> *It is in exchanging the gifts of the earth that you shall find abundance and be satisfied.*
> *Yet unless the exchange be in love and kindly justice, it will but lead some to greed and others to hunger.*[28]

Laborers can transform in production, and, hence, traders can exchange in the market only what has first been yielded by the earth, which exists for our sake only on account of nature's capacities and, ultimately, God's goodness. All the capital we store up by labor, therefore, derives originally from nature's store—and God's gift—of good.

The fundamental fact of human economy is that all labor and exchange is inherently dependent on a primitive "given." Human production and market trade is neither self-starting nor self-sustaining and, thus, cannot be reduced to self-interest. This truth carries important implications for both how we understand human nature in relation to economic activity and how we think about the marketplace itself.

Human Economy and Human Nature

The (neo-)classical view of economic man (as the traditional discourse phrased it) characterizes human existence by rational trade between independent actors: The human being is "man the trader" whose reason directs him to satisfy self-interest by exchange.[29] All else in (neo-)classical economic theory, from the division of labor to the profits of capital, is derived from the idea of rational self-interest. As popularized in the egoist ethic of Ayn Rand, rational self-interest is the moral principle and chief virtue of the individual who exists for him- or herself.[30]

This view of economic man is inadequate, for its vision of the human being as an independent actor neglects to account for the fundamental fact of human economy. The inherent dependence of labor and exchange upon a primitive given implies that the human being is, first, neither trader nor even producer but beneficiary—"man the dependent." The divine beneficence on which human economy depends, moreover, entails moral obligations for economic actors. The gifts of God are free for all; by the same token, the freedom to use the gifts of God is circumscribed by the obligation to serve the common good rather than merely one's own interest (cf. Gal. 5:13; 1 Cor. 12:7). As Benedict writes, the gift of God comes with the duty of stewardship:

> The environment is God's gift to everyone, and in our use of it we have a responsibility towards the poor, towards future generations and towards humanity as a whole.… It [viz. nature] is prior to us, and it has been given to us by God as the setting for our life.… Nature is at our disposal not as "a heap of scattered refuse" but as a gift of the Creator who has given it an inbuilt order, enabling man to draw from it the principles needed in order "to till it and keep it" (Gen. 2:15) … the natural environment is more than raw material to be manipulated at our pleasure; it is a wondrous work of the Creator containing a "grammar" which sets forth ends and criteria for its wise use....[31]

The egoist ethic cannot accommodate the inherent dependence of market exchange on a given good for that would be to recognize an obligation prior to self-interest. By making self-interest the all-sufficient basis of rational action, this view denies the objective fact of our inherent dependency—and thus ignores both the fundamental priority of divine grace over human initiative and the moral obligation of human stewardship of the divine given.

The cardinal virtue of economic activity ought instead to be *gratitude*. A disposition of gratitude recognizes ourselves as who we are—dependents upon and thus beneficiaries of nature's capacities and, ultimately, God's goodness. From such a disposition of gratitude, we would look differently on market trade—as not only exchanging rights between independent actors but also and more so as Gibran put it, "exchanging the gifts of the earth" bestowed by God for the good of all. Benedict has thus appropriately called for the "principle of gratuitousness" and the "logic of gift" to find their proper place in our economic theory and practice:

> The great challenge before us, accentuated by the problems of development in this global era and made even more urgent by the economic and financial crisis, is to demonstrate, in thinking and behaviour, not only that traditional principles of social ethics like transparency, honesty and responsibility cannot be ignored or attenuated, but also that in *commercial relationships* the *principle of gratuitousness* and the logic of gift as an expression of fraternity can and must *find their place within normal economic activity*. This is a human demand at the present time, but it is also demanded by economic logic. It is a demand both of charity and of truth.[32]

Human Economy and Market Theory

When we turn to market theory, we find again that the (neo-)classical view takes for granted the fundamental fact of human economy. Adam Smith, in positing human labor as the original source of economic good and thus the departure point of economic theory,[33] had already passed over the obvious: human labor can produce nothing unless it first appropriates nature's store of good. When considering "that original state of things which precedes both the appropriation of land and the accumulation of stock," Smith thus observed that the entirety of production belongs to the laborer as wages because there is neither master nor landlord to be paid.[34] Now that the original state of things has been eclipsed, Smith continued, we can simply proceed with calculating the economic consequences of the enclosure of the commons without considering its moral implications. Natural goods appropriated from the common store into private possession are not encumbered with any obligations; once held, land and stock can simply be employed exclusively to the owner's profit.[35]

Classical market theory thus assumes that traders enter the marketplace having no prior obligations that might limit the pursuit of self-interest, such that the only moral obligations one has in the marketplace derive from mutual contracts. In assuming as much, market theory neglects to account for the fact that the productivity of labor is necessarily leveraged upon the goods of nature. Theologically, the goods of nature are gifts of God, requiring no human labor for their generation; economically, however, the goods generated by nature are the prime capital investment in production, borrowed from nature by the laborer or capitalist. A full accounting of the production of labor thus requires an assessment of the interest owed by labor and capital due to their leverage on nature's capital investment. Forgetting this fact frees market theory from the moral question of what obligations might exist prior to market exchange.

Such forgetting is the origin of a common principle in market theory—that, in Smith's formulation, "the produce of labour constitutes the natural recompense or wages of labour."[36] This principle has been held by Smith and his ideological critics alike. A century after Smith, Henry George not only affirmed this principle[37] but also made the argument better than did Smith:

> Thus there is to everything produced by human exertion a clear and indisputable title to exclusive possession and enjoyment, which is perfectly consistent with justice, as it descends from the original producer, in whom it is vested by natural law.…Thus, my exclusive right of ownership…springs from the natural right of the individual to the use of his own faculties.[38]

This accepted thinking requires scrutiny. Does the laborer in the original state of things have exclusive right to the entirety of his production? We agree that, by natural law, one has exclusive right to that which is produced entirely out of one's own labor—and, further, that such right of ownership is grounded, as George said, in "the natural right of the individual to the use of his own faculties." Production does not simply spring from one's own faculties, however, but is necessarily leveraged upon nature's goods. Human labor can produce nothing entirely out of itself. Only divine creativity is not leveraged—hence, God has exclusive right to the entirety of creation (cf. Ps. 24:1–2). All production proceeds on borrowing, as it were, and thus entails obligations—*unless* what is appropriated from nature is simply free, as both Smith and George assumed.

Recognizing that human production is inherently dependent on natural goods, the principle that the laborer in the original state has exclusive right to the products of labor must assume that the goods of nature come to the laborer free of any obligation. This prior assumption, which Smith left implicit, George made explicit: "For the right to the produce of labor cannot be enjoyed without the right to the free use of the opportunities offered by nature."[39] That labor must access and employ the goods and capacities of nature (land) to produce wealth is, of course, true. That all laborers have by nature an equal right of access is also true, but does it follow that such right of use is simply free?

An unrestricted right of free use might exist if human production, like divine creation, generated no losses. It is a law of nature, however, that human production inevitably diminishes and degrades the goods and capacities of nature upon which the productivity of labor depends. What nature supplies to human labor is thus free to only the one who appropriates and employs it, while to all other laborers it is a loss (if only of opportunity)—unless nature's capacities and stores are inexhaustible and unlimited, which they are not. Although he did acknowledge the inherent dependence of human economy on nature's capacities, George neglected to account for the obligations entailed by such dependence. Accordingly, George failed to recognize that the original relationship of labor to land is not only one of freedom but also one of obligation.

Two centuries earlier, John Locke had argued similarly for the natural right to one's labor: "Though the earth and all inferior creatures be common to all men, yet every man has a property in his own person. This nobody has any right to but himself. The labour of his body and the work of his hands, we may say, are properly his."[40] As would George, Locke extended this natural right to one's own *labor* to the exclusive ownership of the *products* of one's labor: "Whatsoever, then, he removes out of the state that nature has provided and left it in, he has mixed his labour with it, and joined to it something that is his own, and thereby makes it his property. It being by him removed from the common state nature placed it in, it has by this labour something annexed to it that excludes the common right of other men."[41]

Now, Locke immediately qualified this argument in a way that Smith and George did not: "For this labour being the unquestionable property of the labourer, no man but he can have a right to what that is once joined to, at least where there is enough, and as good, left in common for others." The exclusive right to the product of labor, as we argued above, is thus conditional—as long as production generates no losses of good or opportunity, which are unavoidable in any case.

This point aside, Locke's argument relies on a nontrivial assumption. Locke has argued that, when a person joins his labor to a good appropriated from the common store of nature, the entire product becomes thereby his exclusive property because the individual labor added to the natural good "excludes the common right" of others. Locke has thus asserted here, by fiat as it were, that the transformation of a natural good by human labor nullifies all "common right" in that natural good.

Why should that be so? In fact, everything that human labor produces comprises *both* what belongs to oneself (one's own faculties) and what belongs to all (nature's goods). Nothing humans produce is entirely the product of human labor but is essentially dependent on natural goods that are divinely intended to serve the common good. Because the divine intention is that all should benefit from nature's store, then, unless we are to allow that human action can nullify divine intention, natural goods transformed by human labor do remain within reach of the common right. The products of labor, that is, are under moral obligation to the common good even though they be held in private possession. Christian tradition—from Saint Basil in the fourth century to Saint Thomas in the thirteenth century to the Roman Catholic bishops in the twentieth century—has thus maintained that while private appropriation of natural goods from the common store is justified by natural law, private property is nonetheless encumbered with a "social mortgage."[42]

To summarize: Human economy proceeds on divine grace; for the productivity of labor is dependent on value borrowed from the common store of nature, which is divinely destined for the good of all. This dependence precedes the enclosure of the commons, such that individual labor and private possession are bounded by moral obligation. Even in the original state, therefore, although there is nothing owed to the company store, yet there is something owed to the common good. Now, what has all this to do with the financial crisis?

Human Economy and the Financial Crisis

The fundamental fact of human economy applies at successive levels of economic activity. The financial markets are inherently dependent on the real economy—the economy of actual work and real assets—no less than the real economy is inherently dependent on nature's stores. Because derivatives (credit-default swaps) derive their value from the underlying credit instruments (mortgage-backed securities), and securities derive their value in turn from the underlying assets (houses), securitization and derivatization can generate no profits apart from primary investments of actual labor into real assets. Just as the wages of labor are dependent on the stores of nature, so the profits of trading paper are dependent upon those who generate wealth through work. The one who trades in securities or derivatives, although in a quite different market position, is in no different a moral position than the one who labors on the land. As the economic activity of each is inherently dependent on a given value, so each is in a position of moral obligation: both are encumbered with the duty to steward the given value upon which depends the potential profits of their respective activities.

Traders in the securities and derivatives markets, insofar as they have acted as having no obligation other than to self-interest, have thus not acted in good faith. Just as, say, intensive farming or over-harvesting can exhaust the soil or collapse a fishery, so unconstrained self-interest in financial investments has contributed to the collapse of housing, credit, and stock markets, leaving responsible homeowners, small businesses, and ordinary investors unable to conserve and utilize the wealth they had generated through work.

Gibran's warning that we be wary of the "barren-handed" traders "who would sell their words for your labour" is thus most timely, as is his counsel: invite such market actors to invest themselves into the real economy of human labor and sustainable wealth.[43] Just as laborers have a moral obligation to steward the land by maintaining its productivity, for the sake of the common good and future generations, financial traders have a moral obligation to serve the long-term good of the primary investors in real assets. Benedict thus appropriately calls the financial sector away from the pursuit of narrow self-interest and toward the larger goal of human development: "*Finance*, therefore—through the renewed structures and operating methods that have to be designed after its misuse, which wreaked such havoc on the real economy—now needs to go back to being an *instrument directed towards improved wealth creation and development*."[44]

Gift, then, always precedes both labor and capital; or, we might say, dependence and leverage is the original position of every market actor. Because all labor (and so capital) must borrow from the common store of nature's goods, production and exchange are always already obligated to the common good. Insofar as all economic activity is founded on a given value, moral obligation surpasses self-interest even before we enter the marketplace. It is only by forgetting our inherent dependence on divine grace dispensed through created goods that we can neglect our original obligation to the common good. Such forgetting of divine grace and neglect of the common good in the name of self-interest, Benedict observes, stems from the root of all human ill: "Sometimes modern man is wrongly convinced that he is the sole author of himself, his life and society. This is a presumption that follows from being selfishly closed in upon himself, and it is a consequence—to express it in faith terms—of *original sin*."[45]

When we fail to observe "love and kindly justice" toward others in our transactions, as Gibran wrote, our rational exchange for self-interest "will but lead some to greed and others to hunger"—or, in the present crisis, some to millions and billions in bonuses and bailouts and others to losses of jobs and homes.

Notes

1. Cf. Fareed Zakaria, “The Capitalist Manifesto: Greed Is Good (To a Point),” *Newsweek*, June 22, 2009, 41–45.
2. Peter S. Goodman, “The Reckoning: Taking a Hard New Look at a Greenspan Legacy,” *The New York Times*, October 9, 2008, A1.
3. Goodman, “The Reckoning,” and Joseph Stiglitz, “Capitalist Fools,” *Vanity Fair*, January 2009.
4. “Wild Animal Spirits: Why Is Finance So Unstable,” *The Economist*, January 22, 2009.
5. Alan Greenspan, Testimony to Committee of Government Oversight and Reform, October 23, 2008.
6. “In Plato’s Cave,” *The Economist*, January 22, 2009.
7. Paul Krugman, “How Did Economists Get It So Wrong?” *The New York Times*, 6 September 2009, MM36, New York ed.
8. Stiglitz, “Capitalist Fools,” and Darrin W. Snyder Belousek, “Greenspan’s Folly: The Demise of the Cult of Self-Interest,” *America*, 30 March 2009, 10–18.
9. Eliot Spitzer, “Making Up for Years of Neglect,” *Newsweek*, March 30, 2009, 24.
10. Keith Ernst, Debbie Bocian, and Wei Li, *Steered Wrong: Brokers, Borrowers, and Subprime Loans* (Durham, N.C.: Center for Responsible Lending, April 2008).
11. Greenspan, Testimony.
12. Paul Krugman, “Bubbles and the Banks,” *The New York Times*, January 8, 2010, A27.
13. Paul Krugman, “The Market Mystique,” *The New York Times*, March 27, 2009, A29.
14. Tavakoli, Transcript of interview on Q & A, C-Span, April 19, 2009. http://www.q-and-a.org/Transcript/?ProgramID=1228.
15. Martin Hellwig, *Systemic Risk in the Financial Sector: An Analysis of the Sub-Prime Mortgage Crisis* (Bonn: Max Planck Institute for Research on Collective Goods, November 2008).
16. A. Michael Spence, “Lessons from the Crisis,” PIMCO Viewpoints, November 2008.
17. Cf. Richard Bookstaber, “Blowing up the Lab on Wall Street,” *Time*, August 16, 2007, and “When Markets Turn,” *The Economist*, January 22, 2009.

18. See Edmund L. Andrews, “Greenspan Concedes Error on Regulation,” *The New York Times*, October 24, 2008, B1.
19. See Elizabeth Warren, *Special Report on Regulatory Reform: Modernizing the American Financial Regulatory System* (Washington, D.C.: Congressional Oversight Panel, January 2009); Ben S. Bernanke, “Financial Reform to Address Systemic Risk,” speech at Council on Foreign Relations, 10 March 2009; Robert E. Litan, *Regulating Systemic Risk* (Washington, D.C.: Brookings Institution, 2009); and Timothy Geithner and Lawrence Summers, “A New Financial Foundation,” *The Washington Post*, 15 June 2009. For a contrary view, see Peter J. Wallison, *Systemic Risk and the Financial Crisis* (Washington, D.C.: American Enterprise Institute, 2008).
20. Pope Benedict XVI, Encyclical Letter *Caritas in Veritate* (2009), no. 32, original emphasis.
21. Cf. Zakaria, “The Capitalist Manifesto,” and Amartya Sen, “Capitalism beyond the Crisis,” *New York Review of Books*, vo1. 56, no. 5, March 26, 2009.
22. Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776), bk. 1, chap. 2 and bk. 2, chap. 4.
23. Benedict XVI, *Caritas in Veritate*, no. 35, original emphasis.
24. Smith, *Wealth of Nations*, bk. 2, chap. 2.
25. Paul Krugman, “Innovating Our Way to Financial Crisis,” *The New York Times*, December 3, 2007.
26. Joseph Stiglitz, “The Fruit of Hypocrisy,” *The Guardian*, September 16, 2008.
27. Krugman, “Innovating Our Way to Financial Crisis” and Warren, “Special Report on Regulatory Reform.”
28. Kahlil Gibran, “On Buying and Selling,” in *The Prophet* (New York: Knopf, 1966), 37–38.
29. Cf. Smith, *Wealth of Nations*, bk. 1, chap. 2.
30. Ayn Rand, *The Virtue of Selfishness* (New York: Signet, 1964).
31. Benedict XVI, *Caritas in Veritate*, no. 48.
32. Ibid., no. 36, original emphasis.
33. Smith, *Wealth of Nations*, Introduction.
34. Smith, *Wealth of Nations*, bk. 1, chap. 8.

35. Ibid., bk. 1, chap. 11; bk. 2, chap. 1.

36. Ibid., bk. 1, chap. 8.

37. Henry George, *Progress and Poverty* (1879), bk. 1, chap. 3.

38. Ibid., bk. 7, chap. 1.

39. Ibid., bk. 7, chap. 1.

40. John Locke *Second Treatise of Government* (1690), chap. 5 (original emphasis omitted).

41. Ibid.

42. Thomas Aquinas, *Summa Theologica*, II-II, Q. 66, A. 7; Pope John Paul II, Encyclical Letter *Centesimus Annus* (1991), nos. 30–43; United States Catholic Conference, Pastoral Letter *Economic Justice for All: Catholic Social Teaching and the U.S. Economy* (1986), nos. 110–15.

43. Gibran, "On Buying and Selling."

44. Benedict XVI, *Caritas in Veritate*, no. 65, original emphasis. Cf. Stiglitz, "The Fruit of Hypocrisy" and Paul Krugman, "Making Banking Boring," *The New York Times*, April 10, 2009, A23.

45. Benedict XVI, *Caritas in Veritate*, no. 34, original emphasis.