The Global Quest for *Tranquillitas Ordinis*. Pacem in Terris, Fifty Years Later
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Harmony between Man and Man, and Man and Nature

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In this brief paper, I take up some of the critical ethical issues in the context of economic behavior posed by the necessity of creating harmony between man and man, and man and nature, focusing in particular on several issues raised by *Pacem in Terris* which are of central concern to economic life today.

The world is still suffering from the aftershocks of the financial crisis of 2008. Much has been written about the excesses of the financial sector – such as excessive leverage and excessive risk taking – which imposed such high costs on the rest of society. But there are two aspects of this crisis which have not drawn sufficient attention.

The first is the moral turpitude that many in the financial sector demonstrated. By now, there is ample evidence of many in the financial sector targeting and exploiting the least educated and the least financially sophisticated, in the attempt to maximize profits. In the end, the banks were hoisted on their own petard – but then government came into rescue the banks, letting those who had been exploited to fend for themselves. Those in the financial sector were supposed to have the expertise to manage risk and to design financial products appropriate to those at the bottom of the pyramid, helping them to manage the risks that they faced. They abused the trust that was put in them.

The second is that the rewards of those in the financial sector were totally incommensurate with their contributions to society, or even to the firm on whose behalf they were supposed to be working. This was demonstrated most forcefully in the period immediately after the crisis, in which many firms continued to pay "performance" bonuses, while profits had become demonstrably negative – so negative that the government had to step in to rescue the firms – and workers were being laid off. An economic system where some do extraordinarily well – unrelated to societal contribu-

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tions but rather to their ability to extract "rents" out of the system, whether it is a result of deficiencies in corporate governance (a legalized version of corporate theft) or of the effective enforcement of competition policy (the exploitation that arises from monopolization) – is not a just economic system. This is all the truer if the gains at the top are the result of the exploitation of those at the bottom.

Not long after the financial crisis showed how one part of our economy and society could impose enormous costs on others, the American economy experienced another example: the BP disaster in the Gulf of Mexico. In shortsighted attempts to save money, BP had gambled, putting at risk the lives of its workers, the livelihoods of thousands in the Gulf region, and the environment. Though BP has been forced to pay a high price, the price is still far smaller than the damage that it has inflicted.

Both the BP disaster and the financial crisis are examples of externalities. In our integrated society, actions by one individual or firm have consequences for others. If we are to live in "harmony" then we have to take these consequences into account. Ideally, it would be part of our moral fiber, our ethics, that we do so – just as it would be part of our moral fiber not to exploit those who are disadvantaged. But it should be evident that we cannot rely on morals alone, though a central part of public policy should be to raise awareness of externalities and of the ethics of exploitation. And that means that systems of regulation and accountability (with those imposing costs on others, or on the environment) being forced to bear the consequences. The position taken by some corporate managers along the following lines is unconscionable: that (a) they should maximize the profits of their corporations – that is their fiduciary responsibility; (b) that they should not bear the full consequences of their actions (e.g. by means of limited liability, in general, or limiting liability in specific circumstances, such as in the case of nuclear or shipping disasters); and (c) there should not be regulations restricting their ability to impose harm on others.

Today's economic order and *Pacem in Terris*

A perusal of *Pacem in Terris* shows the extent to which the current global economic order is inconsistent with Pope John XXIII's Encyclical. I cite a few examples:

11. [Man] *has the right to the means necessary for the proper development of life, particularly food, clothing, shelter, medical care, rest, and, finally, the necessary social services.*

And yet, even in the United States, the richest country of the world, the right to access to health care is not recognized, and one out of seven Americans face food insecurity.

18. *...a man has the inherent right...to be given the opportunity to work.*
And yet, in the advanced industrial countries, millions who would like a job can't get work, let alone *decent work:* almost one out of six Americans who would like full time employment can't get it. Fifty percent of the youth in Spain and Greece cannot find work, as hard as they try. Our economic system has failed to meet the most basic of aspirations.

In the almost fifty years since the Encyclical, there has been progress in many of the areas outlined by the Encyclical. But the progress has made the remaining gaps even more glaring. The Encyclical announces that:

19. *The conditions in which a man works...must not...militate against the proper development of adolescents to manhood.*
On the positive side, there has been progress in restricting child labor, including international conventions. On the negative side, child labor remains a reality, and even the United States, for example, has failed to ratify the Convention on the Rights of the Child.

20. *...The amount a worker receives must be sufficient, in proportion to available funds, to allow him and his family a standard of living consistent with human dignity.*
But many firms do not pay a livable wage, and there has actually been a deterioration in the minimum wages in the United States.

30. *...one man's natural right gives rise to a corresponding duty in other men.*
56. *....it is in the nature of the common good that every single citizen has the right to share in it....*
To provide for the basic dignity and rights outlined in the Encyclical, governments need to provide assistance to the disadvantaged, and this requires a combination of voluntary contributions and taxation. And yet many among the wealthy do not make adequate voluntary contributions, and openly oppose the imposition of the imposition of progressive taxation that is necessary for the State to provide even the most basic services.

53. *Men...must harmonize their own interests with the needs of others...*
The objective of regulations is to avoid the imposition of externalities by one individual or group of individuals (corporations) on others. And

yet, there is extensive opposition, especially in some parts of the business community, to the imposition of the regulations so necessary to "harmonize" the interests of different members of society.

General principles

The examples given in the first section of the paper are only two of many that illustrate the challenges – and failures – in creating harmony between man and man in nature in the modern economy. There are many poor. Trade policies of the advanced industrial countries serve to further impoverish the poorest in the poor countries. Natural resource companies often exploit the resources of the poorest countries, destroying the environment and health of those countries, and providing those countries inadequate compensation. There is a common refrain of the Occupy Wall Street movement, the *Indignados* of Spain, and the young protestors around the world: the economic and political system has failed. A world in which there are simultaneously huge unmet needs and underutilized resources – homeless people and empty homes, workers wanting to contribute to society and work hard who cannot find a job – is obviously inefficient. But our economic and political system is also unjust and unfair, a view shared by an increasingly large part of the citizenry. In some dimensions, there has been progress. At the time of the Encyclical, there was, in the United States, massive racial and gender discrimination. Extensive discrimination still exists, but matters now are far better than they were then.

But in one dimension, matters have become worse: in the United Sates, and many other countries, not only is there more inequality, there is less equality of opportunity. The extremes of inequality attained in the United States (with the upper 1 percent garnering some 20% of the nation's income and holding some 40% of the nation's wealth) have been of particular concern, especially since much of the wealth at the top is associated with rent-seeking rather than genuine (societal) wealth creation. Of perhaps even greater concern is the fact that one's destiny increasingly depends on the economic and education background of one's parents.

In this, the final section of this brief paper, I want to generalize the examples, by articulating a few general principles, some of which can be seen as reframing precepts articulated by *Pacem in Terris.*

The economy as a means to and end rather than an end in itself; man does not exist to serve the economy – it is the other way around

As obvious as these precepts seem, in practice they are often ignored. Governments seek to maximize Gross Domestic Product (GDP) rather than societal well-being. But GDP is not a good indicator of societal well-being, as emphasized by the work of the *Commission on the Measurement of Economic Performance and Social Progress.* GDP per capita can be going up, even though most citizens can be becoming worse off (as has been the case in the US now for more than a decade). GDP can be going up, but individuals can be faced with more anxiety, and more insecurity. GDP can be going up, but individuals can become more alienated from each other – social distance can be increasing, conflict and violence (and concomitant metrics on incarceration) can be increasing. GDP can be going up, but the current generation may be living in such a way as to deprive future generations of an equal chance of success. Growth may not be sustainable, either economically, socially, politically, or environmentally.

The controversies posed by globalization highlight the issues at play. Globalization was sold as leading to increased economic performance. In some countries, it unambiguously did that – even if globalization was not "fair" and was far from well managed. But in other countries, the consequences are more debatable. Meaningful increased economic performance should be reflected in higher income for most individuals. Yet in some advanced industrial economies (such as the US) most households are worse off today than they were a decade and a half ago. And some advocates of globalization have simultaneously argued for cutbacks in social expenditures, saying that it undermines the country's ability to compete. If this were done, the plight of those in the bottom and middle would be even worse.

The financial sector – which before the crisis in the United States and United Kingdom garnered some 40% of all corporate profits – also illustrates an economy out of harmony. Just as the economy and economic policies (like globalization) are supposed to enhance the well-being of *most* citizens, so too the financial sector is not an end in itself, but is supposed to enhance the performance of the economy. But the evidence is to the contrary: it is supposed to allocate capital, manage risk, run an efficient means of payment, and provide credit to new and growing businesses, especially small and medium-sized enterprises. The crisis showed that the financial sector had misallocated capital, and created risk. It has become the major impediment to the creation of an efficient electronic payment mechanism reflecting the technology of the 21st century. And small and medium-sized enterprises have been starved for capital, as the financial sector focuses its attentions on highly profitable, non-transparent, speculative activities.

Adam Smith and the invisible hand

No idea has had more influence in economics than Adam Smith's notion of the invisible hand – that the pursuit of self-interest (profits) leads, as if by an invisible hand, to the well-being of society. That notion has been part of the justification for the claim that firms should maximize their profits, and that government should not interfere with this by the imposition of regulations.

In the aftermath of the financial crisis, few would argue that the banks' pursuit of their self-interest led to the well-being of the economy or our society. But the flaws in the "Smithian view" are deeper, and have been the object of research in economics for the past fifty years – well before Thatcher-Reagan market fundamentalist ideas became current. We know that so long as information is imperfect and asymmetric, so long as markets are incomplete (that is there do not exist, for instance, insurance markets for all contingencies), so long as markets are not perfectly competitive the pursuit of self-interest does *not* lead to economic efficiency. And because information is always imperfect and asymmetric, because markets are always incomplete and because markets are never perfectly competitive the pursuit of self-interest essential *never* leads to economic efficiency. What is interesting is that even the welfare of stakeholders of the firm (say different groups of shareholders) is not in general maximized by the firm's pursuit of profit (or market value) maximization.

It would, in some sense, be nice if Adam Smith had been right. (Though I should emphasize that Smith himself was not a Smithian: he understood the limitations of markets. The problem lay with the latter day advocates of unfettered markets). For if the invisible hand theorem were true, it would mean that the only "immoral" act would be to be not sufficiently selfish, for it would only be as a result of not pursuing one's self-interest that efficiency could possibly be destroyed.

Since the pursuit of self-interest does not lead to general well-being, it means that individuals ought to think about the consequences of their actions for others. *Ethics matters.* But as I suggested earlier, we cannot rely on individuals' ethical conduct alone.

There is a need for government policies to "correct" these market failures. While governments are never perfect, and therefore never "perfectly" correct these market failures, every successful economy and society has entailed some role for government correcting market failures.

Government action is essential if there is to be harmony between man and man and man and nature.

The government action can take on a number of different forms – government spending, government regulation – and in general both are required.

Fairness and a just distribution of income

Most advocates of Smithian economics recognize that even if the pursuit of self-interest leads to an efficient economy, it does not necessarily result in a desirable or even acceptable distribution of income. (To be sure, some argue for trickle-down economics, that if those at the top do well, everyone will benefit. While there never was theory or evidence in support of this hypothesis, what has happened in the US in recent years provides strong evidence to the contrary).

The question of what might be meant by a "just" or "fair" distribution of income has long been debated, and I cannot address the issue in this short paper. I make only a few comments: first, if there are inequalities, they have to be justified, e.g. as a result of differences in societal contributions and/or as necessary to elicit efforts from which *everyone* benefits (the Rawlsian perspective). But as the recent crisis so forcefully demonstrated, there was little relationship between the compensation of top executives and their social contributions. Indeed, the design of performance pay in the US and most other countries shows that pay is not meant to reflect managers' marginal contribution. To put the matter in another way, those who have made the most significant societal contribution – those who have made, for instance, contributions to the intellectual breakthroughs that led to the computer, the transistor, or the laser – have earned but a pittance compared to the financial sector CEOs that brought the world to the brink of ruin.

Secondly, not only is it hard (impossible) to justify the disparities between those at the top and the bottom, not only is it hard to justify the extremes at the top, it is hard to justify not doing more for those at the bottom. Earlier, we quoted *Pacem in Terris* as arguing for what is called in modern parlance "a livable wage" (*...The amount a worker receives must be sufficient, in proportion to available funds, to allow him and his family a standard of living consistent with human dignity*). This does not necessarily imply a high minimum wage. The livable wage may be achieved through a combination of a minimum wage and an "earned income tax credit". But what it does imply is that firms not exploit their workers, by taking advantage of asymmetries in bargaining power – asymmetries to which globalization has contributed. (It seems particularly unjust when firms say that they cannot *afford* to pay their workers a livable wage, and at the same time pay their CEOs and other executives large sums not justified, nor justifiable, in terms of their contributions to society, or even to the firm).

Exploitation

There is a more general point: inequalities that arise out of exploitation are, by their nature, *unjust*. But that, of course, just pushes the question back a little further: how do we define exploitation?

We have an intuitive sense of what exploitation is – we know it when we see it – and I don't have much to add beyond those intuitions. Surely, taking advantage of information asymmetries (as Goldman Sachs and Citibank did with the buyers of some of their securities, constructing securities *designed to fail*, and not informing the buyers that they had done so, thus violating basic fraud statutes) is clearly an example of exploitation. So is the abuse of monopoly power (evidenced in the many cases brought against Microsoft).

But the most egregious are the examples of exploitation of the poor, the hallmark of the financial sector, not only in its subprime lending, but in its other predatory and usurious lending and abusive credit card practices.

Externalities

Exploitation not only gives rise to inequalities, but also to inefficiencies, again so manifest during the crisis. But in this and the next subsection, I want to focus on market failures more narrowly defined, i.e. those associated with inefficiencies, where private rewards and social returns are not in alignment. The most obvious examples are those associated with externalities, exemplified by the BP spill discussed in the first section.

As I suggested earlier, regulating externalities is necessary if there is to be harmony between man and man, and man and nature. And no environmental externality is of more importance than that associated with carbon emissions leading to global warming. Our planet is being put in peril.

But we can also view this through the perspective of *justice.* The rich countries of the North are largely responsible for the increased concentration of greenhouse gases in the atmosphere – the burning of fossil fuels has been at the center of their economic success – but the consequences are disproportionately felt by those in tropical regions, predominantly countries that are much, much poorer. As the rich drive their gas guzzling SUVs, they *should* be aware that the benefits of doing so are more than offset by the costs imposed on the poor, for example in increasingly drought-prone regions of India and Africa. As they consume more meat, a sign of their higher standard of living, they drive up the price of basic food grains. As farmers respond by using more water and fertilizer, ground water levels fall and soils may become exhausted. And yet, just as the executives pay little attention to the social consequences of the inequality to which their compensation schemes have given rise, the rich in the developed countries have paid little attention to the social and economic consequences of their consumption decisions – including those mediated through the environment. So long as they pay the market price, they can sleep in good conscience.

Concluding comments

Our subservience to the ideology of the market should not absolve us of our responsibility to strive to achieve a better harmony between man and man, and man and nature. For market prices do not adequately reflect the costs we impose on others. And this is especially the case when it comes to the environment. For the scarcest of resources – our air and our water – are generally not priced, and even when priced, are not adequately priced. And that means our price system is grossly distorted.

But there are other aspects of what enables us to work together as a society that are also not priced. Scholars like Sir Partha Dasgupta, Kenneth Arrow, and Avner Greif have emphasized the importance of trust and social capital in making our society function. These can be fragile, and once destroyed, hard to re-establish. Some of our banks and other financial institutions, and some other corporations, have worked hard to destroy that trust, with adverse effects on others who behaved well, or would have liked to behave well. While there are some idealized conditions in which competition leads to the well-being of society, there are other conditions in which competition can lead to a race to the bottom. Unfortunately, that aspect of competition has been all too evident in recent years.

It is only by freeing ourselves from a market fundamentalist ideology, by focusing on the distinction between ends and means, by realizing that the pursuit of self-interest does not suffice to achieve societal well-being, that we will be able to achieve a better harmony between man and man, and man and nature. Strong and effective regulation is necessary. But even more important is inculcating a stronger moral compass and corresponding corporate ethics.