

C **ommon sense**

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Finalist

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Even today many people are still clutching their heads and wondering ‘How did we ever get into this situation?’ The economic, financial and housing crisis that the world is now experiencing is appalling, and every aspect of every society throughout the world has been affected by the ‘miracle’ of globalization. Worse, this recession (like so many before it) has been overshadowed by the lack of ethical values – which is the most worrying thing about the whole crisis.

The purpose of this paper is nothing less than to appeal to common sense and the principle of prudence (cast aside for reasons of convenience, self-interest or simply greed) in every area of society, but above all in the financial sector, so that we may return to economic growth that is sustainable in the medium and long term. We have to restore ethical values and live in accordance with the truth, rather than a ‘reality’ invented and sustained by a semblance of controlled market

disequilibrium. When we go to university we are told that the market cannot be controlled, and that we must adapt to it, managing our businesses or investments in response to the changes imposed on us. However, in recent decades we have seen only too often how the market has attempted to control itself using rules whose effect was to heat up an already overheated economy – as dictated by fallible central regulators.

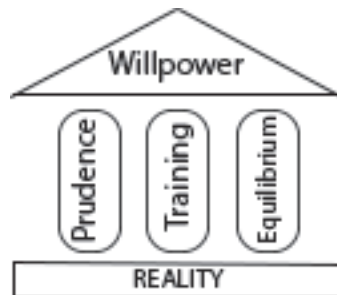
Alexander Pope (1688-1744) said that ‘to err is human; to forgive, divine’. Some have added ‘to rectify is for the wise’ – and, since the damage has been done and there is no point in adding fuel to the fire, we have to be wise, learn from our mistakes and finally see this crisis for what it is: an opportunity for change. To grasp this opportunity, we must erect the basic pillars of growth (prudence, training and equilibrium) on solid ground (reality), with a strong, dynamic roof (willpower) to protect the structure.

See the following illustration:

FINANCE & THE COMMON GOOD/BIEN COMMUN

La crise financière, économique et immobilière a touché l'ensemble de la société, mais elle a surtout mis en avant le manque de valeurs éthiques, ce qui est le plus inquiétant. Le but de ce texte est de faire appel au bon sens et au principe de prudence, dans le domaine financier, afin de revenir à une croissance économique durable. Il faut restaurer les valeurs éthiques et vivre en conformité avec la vérité.

Nous devons être sages, apprendre de nos erreurs et voir cette crise comme une opportunité de changement. Les piliers fondamentaux de la croissance sont la formation, la prudence et l'équilibre, le tout avec de la volonté et une base solide qui est la réalité.



Solid ground: reality

Any decision, whether it be in the economy or in any other area of society, must be based on reality, for otherwise we would not be able to perform even the most basic transactions, from applying for a loan to buying a loaf of bread. To make a decision to consume we first need real money, for however great our desire to consume may be, the inescapable bottom line is reality. Yet financial institutions have responded to our immoderate desire by creating various means of consumer credit or other instruments that have fed this expansion in artificial credit. In recent decades we have seen how decisions made by businesses were largely determined by variables exogenous to the actual market (such as governments, or central banks), forcing economic agents to take unnecessary risks. To take just one example, one of the many causes of the current crisis was the low interest rates imposed by central banks all over the world. By keeping interest rates low, what these institutions did was increase demand for cheap money. The law of supply and demand tells us that, when an increase in de-

mand exceeds the increase in supply, the prices of the product – in this case, the rates of interest on money – must increase in order to maintain market equilibrium. And yet this did not happen. So as not to hamper their competitive growth, the central banks used monetary policy to keep interest rates lower than they should have done. This policy forced financial institutions to increase supply in some way or other just to stay in business. This is where human imagination came into play, with the development of the notorious ‘subprime’ mortgages and other mechanisms designed to turn illiquid assets into securities negotiable on secondary markets. At the same time, under pressure of market forces, financial institutions tried to increase their liquidity by granting loans to people with a high risk of default. This artificial growth in credit was built on the sandy, unreliable soil of a market with too much public intervention. The regulators opened a seemingly protective umbrella that many convinced themselves could never leak. When reality caught up with the institutions’ balance sheets, and hence with all the businesses that had bought these negotiable securities throughout the world, billions of dollars evaporated in a matter of minutes – for balance-sheet assets were recorded at their *market prices*. These were much higher than the assets were actually worth – and now all the unnecessary risks the system had been forced to bear came home to roost.

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Toute décision doit être fondée sur la réalité. Les institutions financières ont répondu à notre désir immérité en créant divers moyens de crédit à la consommation qui ont nourri cette expansion du crédit artificiel. Ces dernières décennies, les décisions prises par les entreprises ont souvent été déterminées par des variables exogènes à la réalité du marché, ce qui a obligé les spécialistes à prendre des risques inutiles.

Alors que le secteur financier repose sur la confiance, l'intervention publique excessive a fortement nui au système financier. Les banques centrales ont perdu le contact avec la réalité.

Si la survie des entreprises financières dépend de la prise en compte de nombreuses variables, elles ont tendance à avoir plus de succès dans leurs démarches que les gouvernements qui confondent rentabilité et intérêt, sécurité et risque.

Our financial system depends on trust. Intermediaries' main function is to ease the flow of money from savers to investors through trust, since savers do not trust investors but do trust financial institutions. If the intermediaries fail to do their jobs properly, trust breaks down – and the system collapses.

Although this is just one example of what has happened in recent years, it is easy to see how excessive public intervention can damage the financial system. When central banks believe they *are* the market and act to maintain sustainable growth within in, they lose contact with reality and with the real value of assets and investments, creating a discrepancy between the risks assumed and the returns to be obtained. This sounds like common sense – and that is precisely what it is. The West has got used to manipulating a market with thousands of variables, most of which are ignored when decisions are made. Cultural standards, levels of satisfaction with politicians and people's levels of education are no less important variables than inflation, interest rates or taxes. Even though businesses' survival depends on taking all these factors into account, they tend to be more successful in their investments than governments, which confuse profitability with interest, and security with risk.

Governments have an important part to play in controlling abuses and protecting investors, especially if they set out to increase the available information on market players.

However, information will never be perfect – this is a natural limitation of the market – and so central banks and other public institutions will never be able to know the full impact of their actions upon the market. Thus, in the clear absence of systemic vision, governments, central banks and other regulators should avoid intervening in the day-to-day workings of the markets, for – among other things – this may favour established major businesses and curb new initiatives that are more innovative and, if they have the necessary opportunity and funding, perhaps more profitable. Markets are fairly free to self-regulate: they find and exhaust opportunities for arbitration; but when information is imperfect abuses also occur, for in that case a handful of people are able to play with a great deal of information. That is why, as stated above, the role of such institutions must be to increase the available information on the market, to penalize abuses by businesses, to protect investors and to supervise compliance with the basic principle of prudence, which will be described below. The result will be a market with less intervention, more freedom and more justice for all.

The role of the regulators must be confined to this, for too much intervention creates a gulf between businesses and reality. The more infallible the regulators think they are, the wider the gulf becomes – and the wider the gulf, the more painful the eventual readjustment. So why not stay as close to the solid ground of



Les banques centrales et autres institutions publiques ne seront jamais en mesure de connaître l'impact de leurs actions sur le marché. En l'absence de vision systémique claire, elles devraient éviter d'intervenir dans le fonctionnement au jour le jour des marchés, qui sont assez libres de s'autoréguler. Ces institutions doivent se contenter d'augmenter l'information disponible sur le marché pour pénaliser les abus commis par les entreprises et protéger les investisseurs. Le résultat sera un marché avec moins d'intervention, plus de liberté et de justice pour tous.

La prudence, premier pilier, signifie étymologiquement la mise en garde que toute personne doit observer lors de la prise de décisions. Directement liée au risque et au rendement, elle est une notion fondamentale pour le système financier.

reality as possible, rather than have to jump off high cliffs to get back down there? *That* is common sense.

The first pillar: prudence

Before discussing the value of this pillar, we need to understand what the word means. Etymologically it comes from the Latin *prudencia*, which in turn comes from the Latin *providentia*, i.e. looking ahead, being able to see the future consequences of one's present actions. In this paper it is used more in terms of accounting, but its etymological origins are the same: prudence means the caution that every person – whether an individual or a legal entity – should observe when making decisions, the ability to analyse and to distinguish the truth amid the haze of disinformation. This pillar is directly related to risk and return: higher rates of return mean greater risk, and so greater prudence is required when making a decision. This pillar is of immense value to the economy. Banks rely on it to stay in business, companies invest on the basis of it and even the smallest investors are very much aware of this principle when making decisions.

Prudence is essential to the financial system, and lack of it is what has got us where we are now. When regulators kept interest rates low, 'anything goes' became the order of the day, and financial institutions threw caution to the winds. Many businesses depend on efficient risk management in order to survive, but it is of truly vital importance to the

success of any financial institution. When banks were forced to keep interest rates low at a time of growing demand for credit, they imprudently granted substantial loans to unemployed people and turned them into liquid assets in order to survive in the competitive market. The lenders took the money and invested it in housing speculation: house after house was bought simply to be sold at a profit, and public investments were made with dubious rates of return, for purely selfish reasons. Regulators also forgot the principle of prudence when they decided to change the rules for company balance sheets so that assets were no longer recorded at their purchase prices but at their market prices – in other words, they artificially inflated trust out of all proportion. Businesses, in turn, were caught in a spiral of competition, interest and speculation that spread to the smallest investors – who have been hit hardest by the whole situation, for they are far worse placed than businesses to obtain truthful information. When reality, and real value, caught up with these inflated balance sheets, the readjustment was very painful for all concerned, but especially for the most vulnerable people: small investors. And this is what has hampered economic recovery most of all – for they, the small savers, are the very people regulators were supposed to protect. They no longer trust the system, and with good reason: their money has vanished in investment funds that were given the highest ratings by supposedly impartial agencies. And

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Beaucoup d'entreprises dépendent de la gestion efficace des risques pour survivre. Ces dernières années, les principes de prudence ont été oubliés, en particulier par les régulateurs quand ils ont décidé de changer certaines règles.

Les petits investisseurs ont été parmi les plus touchés et ont perdu la confiance qu'ils avaient accordée au système. L'intervention des banques centrales et autres institutions publiques dans les marchés doit cesser urgemment.

Il faut être prudent si nous voulons retrouver le chemin du retour à la confiance et à la croissance économique stable. La confiance dans les intermédiaires financiers doit être rétablie.

Le pilier du milieu est la formation. Face au manque de valeurs éthiques dans le système économique et dans l'éducation, il faut privilégier la véritable expérience qui garantit l'efficacité.

now that the agencies have been proved wrong, they are not being forced to face the consequences. Those who have misbehaved beneath the regulatory umbrella must not be allowed to get away with it. It is only when investors see justice done in the market that they will dare to invest and credit will again start circulating through the system – which is why public disintervention in markets is so urgently needed.

In short, companies' and banks' balance sheets must once again record the *purchase* prices of their assets, and prudence must once again become a key part of their decision-making. Only thus, by keeping a cool head, can we find the way back to trust and stable economic growth. It is vital to restore market trust and credibility, otherwise there is a risk that normal market mechanisms will break down. If investors cannot entrust their money to intermediaries – through deposits, investment funds and other instruments – who *can* they trust? Are we about to see the re-emergence of small local moneylenders? Probably not, but we must face the fact that the market's engines have been very badly damaged. Once trust in them evaporated, the whole system ground to a halt.

The middle pillar: training

As already stated, the most worrying thing about the crises we are now experiencing is the lack of ethical values in the economic system and in education, and the disturbing dehumanization of the global edu-

cation system, whose consequences can be seen in all areas of human life. Especially in the economy, professional success has come to depend on greed, selfishness, individualism and lying. The current ideal is to *win*; if you are at the top of the pyramid, you are considered a success. Yet nowadays success is confused with power and fame. To be truly successful, professionals must have experience – not just CVs full of all the right things, but specific obstacles they have surmounted and barriers they have overcome in order to achieve their full potential.

Today, in offices throughout the world, we can observe the phenomenon of demotivation: people unable to find meaning in their lives, wandering through the corridors with no other aim than to get back home at night. The conformity of easy, comfortable living is distracting us from our potential and depriving the world of top researchers, ethical investors and great philosophers. Winning is a concept that is part of success. The dehumanization of education does not mean the end of this – for it is the goal everyone is still blindly pursuing – but something worse, which is mistaken for success: the idea that what you *have* says what you are *worth*. And this is the root of the problems we now face: anything goes, provided you are *worth something*. How often have we seen businessmen commit crimes in order to maximize their personal profits, or governments give preferential treatment



La démotivation croissante dans les bureaux et la déshumanisation des activités financières ont généré la domination du concept de succès. Il est l'objectif à atteindre et il détermine ce que vous valez. Tel est le triste constat actuel.

La seule façon de prévenir la récurrence d'une crise comme celle que nous vivons actuellement est la formation. Les professionnels doivent être formés dans la finance et la comptabilité, mais aussi dans la philosophie, la sociologie et d'autres disciplines humanistes, ainsi que le droit et la politique. Ils doivent apprendre à travailler en équipe, pour unir leurs forces et créer des synergies.

to 'friendly' businesses, purely out of self-interest? Such things destroy trust, and the repercussions are disastrous. Who will ever reinvest in a business whose CEO has run off with millions? Who will deposit their money in a bank that has failed to make a correct market analysis? The lack of truth, information and partnership that appears to underpin professionals' success has destroyed trust both within and outside the system, corrupting it and preventing it from working as it should.

The only way to prevent recurrence of a crisis like the one we are now experiencing is training – but not just any training. What the system needs is professionals with *all-round* training. Excessive specialization, without a broad humanistic base, produces blinkered people. They lack a systemic view of what is going on and end up making the wrong decisions, with serious consequences – and, to make matters worse, unpredictable ones, for people do not know exactly who they are dealing with. The disinformation that affects the system in general – and this is where governments *should* intervene – is aggravated by the poor individual training of its economic agents. Professionals need to be trained not only in finance and accounting, but also in philosophy, sociology and other humanist subjects, as well as law and politics. They must know how to work in teams, so that they can pool their strengths and create synergies. In most industrialized countries' education systems,

teamwork is indeed encouraged – but it is not *taught*, for the social component of man has been forgotten. Teamwork involves collaboration rather than cooperation – in other words, it means that individuals arrive at conclusions and solutions they would not have arrived at by themselves, and so optimize their performance. Such collaboration depends on individuals sharing their ideas generously and openly. This notion is completely at odds with today's culture of the power of information, and yet it is the lack of truthful information – in the Information Age – that has helped us dig this hole under our feet.

Such systemic training of the individual must be provided from earliest childhood right through to postgraduate university studies. Such all-round training will ensure that professionals are able to analyse and understand the problems they face more broadly, fully and holistically, so that they can make the best decisions and keep any adverse consequences to a minimum.

Being an ethical person does not just require good all-round training, but also great determination and awareness in order to make the right choices – a predisposition to do good, which must be promoted by a just society in which bad behaviour has bad consequences. Justice will be done in the economy when the market is free to self-adjust, for it will expel businesses that do not create enough value; but the same coherence must apply to everything professionals do.

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Les professionnels pourront alors prendre de meilleures décisions en minimisant les conséquences fâcheuses. Ils devront faire preuve de détermination et d'une sensibilité accrue. Notre système financier a urgemment besoin d'une génération de professionnels capables de voir au-delà de leurs décisions en étant créatifs et novateurs. Si nous voulons changer le marché, c'est nous même qu'il faut commencer par changer.

Le troisième pilier, l'équilibre, est essentiel. La notion de proportionnalité est ici importante car elle permet de créer une confiance dans le système en le rendant plus prévisible. Le meilleur exemple d'équilibre doit être trouvé dans les entreprises, qui doivent en priorité équilibrer leurs budgets. Pour rester solides, saines et honnêtes, il faut aux entreprises financières un personnel dynamique, une grande prudence et enfin de l'équilibre et de la cohérence pour optimiser leurs performances.

All-round professionals would have made an exhaustive analysis of investment funds before risking their depositors' money in them; all-round professionals would not have jeopardized their companies' viability by speculating in securities that inflated their balance sheets; all-round professionals would have known that high-return investments are also high-risk investments; and so on. Our financial system urgently needs a generation of professionals who are able to see beyond their decisions and be creative and innovative *without forgetting that there is no escaping from reality*. The market is the outcome of the decisions made by the people in it – which means it is simply a reflection. If we want to change the market, we must change ourselves.

The third pillar: equilibrium

Equilibrium is essential in all areas of society, not just the economy. If justice is to be done, the punishment must fit the crime. University results are usually proportionate to the effort the student makes. Such proportionality generates trust in the system by making it to some extent predictable. If the return on a treasury bond is 8%, we know there is a high risk of losing our money. The problem is when this equilibrium is upset and investments that appear to challenge this proportionality rule appear on the market, offering high returns for low risk. Common sense tells us one of two things: either whoever is offering the product does

not know what he is offering (which is most unlikely), or else it is a scam – in other words, people who are better informed than the rest are using their knowledge for personal gain. In recent years, unfortunately, there has been a proliferation of such products, which take advantage of investors' lack of information. Many have been duped, but others have followed their instincts and kept out of trouble.

The best example of equilibrium is to be found in businesses. All businesses have to balance their budgets: their assets must equal their liabilities plus their net worth. In the final stages of the boom, businesses all over the world had balance sheets that were far removed from reality, with billions' worth of underlying losses that remained undeclared thanks to creative accounting by their finance departments. However, as stated earlier, when a business is built on the sandy soil of lies, it ends up leaning like the Tower of Pisa and eventually collapses under its own weight. For a business to remain strong, healthy and upright, it needs three main supporting beams: (1) dynamic staff with all-round training and a systemic view of the market; (2) large doses of caution that encourage it to seek real information about the market, rather than rely on appearances; and (3) equilibrium and coherence, allowing it to maximize its performance because it operates as a whole rather than as the sum total of its various departments.



La volonté est le moteur du changement et le toit principal nécessaire à la croissance. Il faut changer ses habitudes et considérer le bien-être des générations futures. Pour changer la situation actuelle, il faut former les individus et pour cela, il faut une volonté profonde de changement et d'amélioration.

Tout repose sur la volonté, mais utilisée à bon escient, c'est à dire pour le bien être de la société et non pas pour satisfaire des fins personnelles ou une volonté de puissance. Si un seul gouvernement avait eu la volonté de cesser de se focaliser sur le court terme et de tester l'efficacité de ces piliers, la crise n'aurait pas duré aussi longtemps. La volonté protège et garantit les piliers évoqués comme le toit protège une maison. Sans lui, il n'y a que quatre murs à la merci des éléments.

The roof, and the engine of change: willpower

Every journey begins with the first step. To change a situation, you have to want to change it. The leaders of the world's countries have to see their nations' need for change and truth. Willpower is the most difficult part of the structure to build, for it is made up of habits that are acquired by repetition. Good actions lead to good results, and bad ones to bad ones. Willpower is difficult enough at individual level, but with countries the difficulty increases exponentially, for no country wants to take the first step in the wrong direction and risk being left behind on the road to growth. And yet we urgently need to abandon short-term thinking and consider the well-being of future generations. Disinformation, lack of ethics, poor training and greed are now flooding through our financial system, which is a reflection of our society. Whether from ignorance or fear, the citizens of many countries now think of financial markets as ogres. The only way to change this is to train people – and the only way to train them is to want to.

We live in a dynamic world, a complex environment. There are thousands of businesses constantly innovating, and spending thousands of millions on the process. Why? Because the only way to survive in the market is to adapt to the environment. Businesses have to be dynamic

in order to survive, but governments do not. Businesses do not control the market, but simply adapt to it; but governments – far from adapting to market changes – thought *they* were the market. This ignorance turned the desire for change into a desire for power. They all thought they knew what was best, for between them they formed the market. Yet reality, and the real value of investments, trump all speculation. The market has meted out the punishment we deserved. All countries fear change, because what they have seems to work from time to time, and they prefer not to take risks. On the other hand, change brings more change. But not all change is for the better. If it is in accordance with human nature there will be hope; but, if not, we will keep on having the same problems, and keep on destroying ourselves. If just one government had had the willpower to stop focusing on the short term, look beyond the next general elections and test the effectiveness of these pillars, the rest would have followed suit and the crises would not have lasted so long.

Willpower protects the pillars just as a roof protects a house. Faced with a harsh climate and unpredictable events, we must always have the willpower and determination to do the right thing – for a house without a roof would be nothing but four walls at the mercy of the elements.

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La cohérence est une notion très importante car il est nécessaire d'agir et de penser sur la base du bon sens. Quand nous sommes cohérents, nous sommes moins susceptibles de prendre de mauvaises décisions. La cohérence conduit à innover pour créer de la valeur ajoutée, l'incohérence détruisant la confiance dans le monde financier. Nous avons une belle occasion de passer à un modèle de croissance stable et durable à moyen et long terme. Les marchés dépendent finalement des personnes qui les composent. Pour restaurer la confiance, ce sont donc les gens que nous devons changer en priorité.

The beauty of coherence

Besides training or the proposal to reduce public intervention, the purpose of this paper is to raise awareness of the need to act and think on the basis of common sense. The main problem right now is the lack of trust in the financial system – made worse by the lack of information throughout the economic structure. There are many ways to restore trust, some of them very ingenious and innovative, but the most obvious one is also the most effective: common sense. When we act on the basis of common sense, we are coherent, and when we are coherent we are much less likely to make wrong decisions. Coherence means that we will act correctly, but not unadventurously. It leads us to innovate in order to create added value that is recognised by the market, and to make prudent decisions. However, in order to be coherent and prudent, we need a broad basis of training, failing which we could not make judgements and decisions based on reality. This century's professionals have forgotten the systemic view. A decision affects more than one variable; in fact it affects all the variables that depend

on it, and the ability to see these links entirely depends on the person that is looking. That is why we must train professionals to see them – not just the obvious numerical ones, but also the social and human ones, as well as the holistic system of the economy and business. What is more, reality is governed by a key principle that we all have to live by, namely that everything is in equilibrium. When businesses or other institutions fail to take account of this, they lose touch with reality; and eventually that means having to lie. But lies soon catch up with you, and there is a great likelihood of incoherence, which – as already stated – destroys trust.

We are in serious trouble; but the greatest obstacle is refusing to make the necessary leap. We now have a golden opportunity to shift to a stable growth model that is sustainable in the medium and long term. Markets are not good or bad in themselves, but depend on the people within them. If we want to change the direction of the market and create trust, we have to change the people within it.

So let's do it. •



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