

THE CENTRE FOR ENTERPRISE, MARKETS AND ETHICS

ENTERPRISE AND FAITH SERIES

CAPITAL MARKETS
FOR THE GOOD OF
SOCIETY

A CHRISTIAN PERSPECTIVE

LYNDON DRAKE

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The Centre for Enterprise, Markets and Ethics

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THE CENTRE FOR ENTERPRISE, MARKETS AND ETHICS

We are a think tank, based in Oxford, which seeks to promote an enterprise, market economy built on ethical foundations.

We undertake research on the interface of Christian theology, economics and business.

Our aim is to argue the case for an economy that generates wealth, employment, innovation and enterprise within a framework of calling, integrity, values and ethical behaviour leading to the transformation of the business enterprise and contributing to the relief of poverty.

We publish a range of material, hold events and conferences, undertake research projects and speak and teach in the areas with which we are concerned.

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CONTENTS

Preface	7
Introduction	11
1 Criticism of markets	17
2 Theology and utility	23
2.1 Ancient Israel as a paradigm	26
2.2 Christian extension of Israel's paradigm	27
3 Flourishing and justice in society	33
3.1 Creative purpose and human flourishing	34
3.2 Justice and redemption	36
4 Christian economic fairness and effectiveness	41
4.1 Norms from Deuteronomy and beyond	42
4.2 Harmless credit for the poor	44
4.3 Personal economic freedom	46
4.4 Visibly fair pricing	47
4.5 Application to modern capital markets	47
5 Kinds of capital markets	53
5.1 Bond markets	54
5.2 Equity markets	55
5.3 Commodity markets	57
5.4 Currency markets	59
5.5 Money markets	60
6 Issues across markets	63
6.1 Derivative markets	64
6.2 Harmful products	69
6.3 Scandals	69
6.4 Asymmetry of information	70
6.5 Technology and dark pools	70
6.6 Speculation and short selling	72
6.7 Risk management and control	73
6.8 Compensation	73
Conclusion	77

PREFACE

I spent a number of years as a trader, working directly in capital markets. When I was working in London, it often felt like a bit of a dream, because I grew up in a rather poor suburb of Auckland in New Zealand. Walking on to the trading floor in Canary Wharf and being involved in capital markets was to be part of a different world. Whenever I visited New Zealand, I realised my friends and family only dimly understood what I did, reinforcing the sense of distance.

My desire to write about capital markets is driven in part by a hope that my old line of work can be better understood. Despite the impact of the financial crisis, which I traded through, I still believe capital markets are fundamentally beneficial to society. I hope what follows can help to explain why that is the case.

In addition, I believe it is essential to consider the moral basis of the forms a society adopts. While I am slightly too old to be a genuine millennial, I have over time come to share the concerns many millennials have about the structure of society. My own sensitivity has been awakened not primarily by social media but by a growing awareness of the concern expressed throughout the Christian Scriptures for the well-being of society. In Christian thought, well-being is confined neither to an otherworldly spiritual dimension nor to the merely material. I am convinced that human well-being and societal flourishing are best understood in moral as well as pragmatic terms.

Human beings are profoundly moral creatures, and in the end it is our moral sense that drives our economic decision-making, including the ways we structure society.

I have never heard this more clearly expressed than in conversation with a Dutch colleague early in the financial crisis, when sovereign debt contagion was on our radar but not yet treated seriously in the wider market. This colleague told me that Greece should pay its debts, no matter what the

consequences. But what if this led to significant social harm – perhaps leading to a complete breakdown of society?

His reasoning was at root a moral reasoning; after all, there's no objective, non-moral way of deciding whether social chaos or failure to repay debts is the worse outcome.

Assessing the benefits of capital markets to society, and the problems associated with them, inevitably involves some degree of moral reasoning, whether explicitly stated or unquestioningly assumed.

INTRODUCTION

The sea is beautiful in the eyes of God ... because ... it supplies the merchant with his wealth and easily provides for the necessities of life, allowing the wealthy to export their excess, and blessing the poor with the supply of what they lack.

Basil of Caesarea, *Hexaemeron*, Homily 4.7

For much of its history, the Church viewed trade and merchants with suspicion, if not outright hostility. After all, merchants seem to make money from nothing: they buy a pot or some food for one price in one place, and then without the pot or food changing in any way, they sell it on for a higher price.

Basil of Caesarea recognised something virtuous in the process of trade. In a way quite different from philanthropy, trade is one way for the surplus of the rich to be put to use by the poor.

Capital markets provide a similar socially useful function for money. There is a good moral reason for the existence of capital markets, simply on the basis that they make the surplus money of the rich available for use by the poor.

Basil realised that merchants got rich from trade; so too we know that participants in capital markets often become wealthy, which irks many people. So perhaps we should start by thinking about the basic needs capital markets satisfy, and especially about why there needs to be a *market* for capital.

I have recently moved back to the United Kingdom from New Zealand. As part of that move, I needed to convert some money from New Zealand dollars to British pounds. At around the same time, a friend of mine wanted to convert some money from British pounds to New Zealand dollars in order to buy a house in New Zealand. At first sight this looks like the perfect opportunity for a direct economic relationship without the need for

a currency market. Two friends with broadly equal and opposite transactions could surely strike a deal by a direct relationship.

Yet without a market we would find it difficult to trade. The sharp move in the conversion rate between British pounds and New Zealand dollars as a result of the UK referendum vote to leave the EU means that my friend is not inclined to trade at the moment. I, on the other hand, am eager to take advantage of the currency movement.

My friend might be willing to wait and see if rates improve for him – but if they do, perhaps I will no longer want to trade, as the same move that benefits him will adversely affect me.

‘Capital markets have a terrible public image’

What we need is a liquid, active market for currencies. Capital markets provide society with a useful service, helping people like me and my friend to trade when we need to, without simply relying on a coincidence of interests.

The problem is that capital markets have a terrible public image. Markets for shares, bonds and especially derivatives are widely seen as the arena in which investment banks carelessly inflict harm on society. Their main benefits seem to accrue to a small number of highly paid individuals. This seems perverse: a few are apparently rewarded while harming the common good. Some of the most strongly worded criticism of markets has come from religious figures.

Despite this public image, capital markets do have benefits, but since these benefits are somewhat obscure, society risks losing them. This risk has arisen through a perfectly understandable desire in the public sphere to treat the unpleasant side effects of many capital markets.

The benefits of capital markets are poorly understood partly because markets are complex and understanding of that complexity is confined to a few. What is more, those few are often highly involved in markets and already well compensated. As a result they are perhaps disinclined to spend time explaining this complexity to the general public, and because it seems apparent they are defending their own interests, they are certainly not trusted

voices. As a consequence, the negative side effects of capital markets, which can be severe and highly visible to the whole of society, dominate public discourse.

Capital markets do provide an important benefit, recognised even by some critics: ‘the only proven way to lift people out of economic poverty is to make the entire pie bigger by creating new financial resources. Currently the only known economic system that accomplishes this is market-based capitalism.’¹ Similarly, Stephen Green rightly states that ‘at its best [the market] is a highly efficient allocator of capital, and it has delivered huge advantages to humanity.’² As Lord Green goes on to note, the G20 enshrined this recognition of the value of markets – including capital markets – in their statement in April 2009: ‘We believe that the only sure foundation for sustainable globalisation and rising prosperity for all is an open world economy based on market principles, effective regulation, and strong global institutions.’³

Despite this well-established recognition of the value of capital markets, underlying some of the distaste is a latent moral sense, an instinctive feeling that the aggregate benefits are not good enough if they do not accrue to the poorest in society; indeed, that capital markets help a few at the expense of the most vulnerable.

The end result is that the poorly understood benefits of capital markets are ignored or dismissed, while the obvious harm resulting from market failures is very influential in the formation of public policy. This publication presents a case for the benefits of capital markets to society. It uses metrics prompted by Christian theological reflection and gives priority to the effects of markets on the poor. This sets a high bar for measuring their social utility. It is a standard I believe many will consider a justified and relevant way of assessing capital markets, and reflects values widely held in secular Western societies.

1 Kenman L. Wong and Scott B. Rae, *Business for the Common Good*, Downers Grove, IL: InterVarsity Press, 2011, p. 154.

2 Stephen Green, *Good Value: Reflections on Money, Morality and an Uncertain World*, London: Allen Lane, 2009, p. 127.

3 *G20 Communique: London Summit – Leaders’ Statement; 2 April 2009*, 3 April 2009; www.imf.org/external/np/sec/pr/2009/pdf/g20_040209.pdf.