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POSITION PAPER OF THE COMECE SECRETARIAT:[1]

A FINANCIAL SYSTEM SERVING THE COMMON GOOD IN TIMES OF SYSTEMIC CHANGE

The radical newness of the pandemic adds to mounting social tensions and growing climate-related concerns. Pope Francis wrote already in 2016: "We are faced not with two separate crises, one environmental and the other social, but rather with one complex crisis which is both social and environmental" (LS 139). This means that "back to pre-pandemic normal" is - at best - a deceitful illusion. Nolens volens, systemic change is underway as the primacy of individual interest has demonstrated its failure as the panacea to all ills. The systemic transformation will either happen spontaneously with its lot of unpredictable and potentially disruptive consequences, or we can try to lead and set the ground for it. We are convinced that the success depends on all components of social, political and economic fabric taking their share of responsibility and earnestly contributing to the change of hearts and culture without which institutional changes alone will miss their targets. Saint John -Paul II wrote "For an adequate formation of a culture, the involvement of the whole man is required, whereby he exercises his creativity, intelligence, and knowledge of the world and of people. Furthermore, he displays his capacity for self-control, personal sacrifice, solidarity and readiness to promote the common good." (CA, 51).

In Christian perspective, the common good's ultimate horizon is worth all human efforts. On a more practical level, the principles of Christian Social Teaching provide guidance for each of us on how to be part and contribute to ongoing transformation at a personal level, at the level of organisations, of political communities and Sates, as well as on the global level.

The present paper aims to encourage a wide conversation of persons of good will searching together for the most appropriate ways to set the ground for and accompany the above-mentioned systemic transformation. The paper enlightens with principles of Christian Social Teaching, a selection of policy and personal dilemmas in the field of economy and finance in order to help the concerned actors make better informed choices and decisions aiming at the common good.

I. THE CONTEXT

Since early 2020, sanitary concerns have abruptly changed the daily life of world population by bringing some sectors of society to a complete standstill while imposing changes in the organization of work in others. Overnight, across Europe and throughout the world, regardless

[1] This contribution has been elaborated by the Secretariat of COMECE based on the excellent contribution and work of the ad-hoc working group on financial ethics which consisted of: A. Autiero, P. Dembinski, J. Kamerling, Martin Maier SJ, D. Sugranyes Bickel.

of political sensibilities, families, enterprises and public bodies had to cope with radically new situations.

From the very beginning, resilience of the social and economic fabric was put at test and imagination unleashed in all directions to find adequate solutions, in both private and public domains. The pandemic highlighted the key importance of many activities that until then had gone unnoticed. From one day to the next, they came to the fore and were called "*essential*". Many of these activities are (still) carried out in low-pay, low-prestige jobs while another part belongs to the – often unacknowledged - family activity. Beyond the diversity of forms, the pandemic brought to light that "*essential activities*", paid and not paid, such as (health)care and domestic work, security guards, cashiers in local grocery stores, and other types of work in the interest of the common good, must be better valued and recognized. In parallel to the pressing social and economic recognition of essential activities, Pope Francis has recently stressed that care (for the other, the environment and the common good) has to be part of any work or human activity, irrespective of its qualification as essential or not[2].

Due to the pandemic, the State was called in unanimously as the sole actor in position to mobilize gigantic resources and provide assistance to populations and the most affected enterprises. Initially, public policies have focused on sanitary concerns as an absolute priority, but the longer the pandemic lasts, the more pressing the social, economic and financial considerations become.

Today governments, enterprises and families still experiment ad hoc responses to the new economic, financial, social and psychological, not to mention sanitary, challenges, some of which appear as long lasting.

Two main considerations underpin most of these public and private efforts: one is synchronic, the other diachronic: how to share the burden of the crisis among countries, economic sectors, social groups and how to distribute and smooth the burden across generations and between the short and the long term. Financial instruments and policies may be of some help to address each of the two concerns.

When the pandemic struck, twelve years after the global financial crisis (GFC), the financial system was about to emerge more robust than before, thanks to tighter regulations and rescue packages arranged by central banks to contain the consequences of the crisis. These measures have contributed to "*save*" the system, but also resulted in creating highly artificial abundance of liquidity that pushed the interest rates into negative territory and the stock markets to unprecedented highs. In 2020, at the very moment the pandemic took hold of the planet, these measures were supposed to be progressively withdrawn which was expected to cool down the euphoria of the market and drive interest rates back into positive territory. With the urgency of the pandemic related rescue measures, old tensions and risks to financial stability reappeared placing additional demands on central banks' supply of liquidity and by the same token expanding the period of "*unconventional policies*" and of artificial abundance of liquidity.

The post-pandemic economic recovery, with a combination of various geopolitical and climate factors as well as the cost of decarbonization, is presently creating new tensions in supply chains

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2 https://www.vatican.va/content/francesco/en/messages/pont-messages/2021/documents/20210617-videomessaggio-oil.html

and energy prices, and probably encourages inflationary expectations and a deeply different short term context.

As a response to the pandemic, prompted by historically low (or negative) interest rates, public authorities both in and outside the EU, have chosen to run unprecedented deficits to finance long term spending programs aimed at supporting their ailing populations and economies – especially in the EU through its massive recovery plan '*Next Generation EU'* – and to simultaneously foster the ecological transition. The magnitude and complexity of public response – both financial and regulatory - to the pandemic, is having systemic consequences whilst redesigning the frontiers and interfaces between public and private spheres of economic and financial responsibility.

For the EU, the moment is of peculiar importance as the national responses to the pandemic tend to diverge in emphasis, the sovereigntist reflexes gain force as do geopolitical tensions. At the same time, the pandemic has demonstrated the resilience of the European social model based on the respect of human dignity in mitigating the social consequences of the shock. By and large, EU countries have preferred to immediately support the most hardly hit sectors and enterprises softening for some time the process of "*natural selection*" defended by some. This line of action, giving the chance for economic activity to bounce back, is defendable both from the social and economic point of view as from the perspective of Catholic Social Teaching (CST) which states the primacy of labour over capital. The pandemic also provided new reasons to deepen European cooperation and spirit of solidarity, particularly in public finance, and in vaccine and health policies.

Among innovative responses to pandemic urgencies, the EU managed to agree on an unprecedented, long term "*Recovery Plan for Europe*" allowing each member State to address its massive funding needs, also those related to the ecological transition. In consequence, the EU is directly raising the necessary resources in the financial markets and will service the resulting debt directly from the EU budgetary resources. In fact, this mechanism adds an additional layer of unity to the subtle construct of subsidiarity and solidarity in matters of public finance among the member-States.

Today's situation is also unprecedented because of pandemic related issues coinciding with the pre-existing ones due to ecological transition, digitalization, post-Brexit challenges to European unity as well as the emergence of a more fragmented geopolitical landscape. Many of these issues, further stressed by the pandemic, relate not only to public policies but also to the roles and responsibilities of large – often transnational - corporations, to their legal status, governance and supervision, to the corresponding standard settings and regulations, and to their global social and economic responsibilities as focal players in global value chains.[3]

By addressing these challenges, the intergenerational solidarity and fairness in burden distribution have to be part of policy responses as the millennial and Z generation manifest their growing concern about the future and their commitment to long term policies and goals – also at the level of enterprises - particularly those combatting climate change. In this context, action is required. It has to be prudent action, i.e. based on best available knowledge, because of the

3 See COMECE Declaration on binding due diligence legislation: http://www.comece.eu/dl/uNmrJKJKkkkMJqx4KJK/Catholic_organisations_and_the_Church_in_the_EU_welcome_European_legislative_initiative_on_human_rights_and_environmental_due_diligence.pdf

long-term effects and amounts involved. The call to prudence does not suffice to justify lack of action in response to world social and climatic urgencies.

II. MACRO LEVEL DILEMMAS

⇒ Towards a more balanced world

Post pandemic burdens are much heavier for middle- and low-income countries

In comparison, EU, and more generally high-income countries, come out of the pandemic without catastrophic losses in prosperity. This is due to resilient social and political models, and adequate fiscal space. However, the majority of middle- and low-income countries are lacking both, while being confronted with the same sanitary and ecological challenges. In relative terms the post pandemic burdens are therefore much heavier for them to carry. If the EU commitments to the Sustainable Development Goals (SDGs) and related targets are to be taken earnestly, in (post) pandemic times, the EU and high-income societies and countries ought to pay more – not less – attention to the needs of the rest of the world. In consequence, a significant increase of their contribution to international solidarity, and to fairer distribution of resources and risks across the globe will be necessary. Channels and instruments are manifold: increased foreign direct investment flows from private actors, higher contributions to civil society organizations actively involved in low- and middle-income countries, international debt alleviation or cancellation programs, increased support for ecological transition, allocation of significant amounts of special drawing rights (SDR) under the auspices of the International Monetary Fund and their voluntary transfer to countries in need, enforcement of global rules for preventing unjustified profit shifting by multinationals to low tax jurisdictions. In parallel to unilateral actions, EU and each of its member countries ought to strongly voice corresponding concerns and support related proposals in relevant multilateral fora.

> ⇨ The EU should dedicate more attention to support the poorest countries worldwide to repay the ecological debt and respond to the humanitarian emergency of the pandemic.

⇒ Strengthening the resilience of EU social fabric

Fragilities and resilience of the social fabric in Europe

While the pandemic has put in crude light the fragilities of the social fabric across the continent as well as in many Member States, it has also demonstrated its resilience through a number of informal or civil society related initiatives reaching out to the weakest. The stress of the pandemic made visible what often remained unseen: the misery of those lacking the proper relational network and/or appropriate economic resources. The bottom of the increasingly vertical pyramid of inequalities became visible to all. The issue is complex, but in the perspective of CST, three concerns come to the fore: urgency of decent work contracts, decent remuneration (salary or otherwise) and expanded social protection. These are the prerequisites for social peace and increased resilience. The necessary adjustments need to be made at enterprise level but also at fiscal level – especially regarding the highest layer of corporate remunerations which have skyrocketed in recent decades and lack moral justification.

⇨ Financial support to help developing countries should prioritize strengthening their health, education and economic systems. Safe vaccines should be made accessible and affordable for all, starting with health workers and the most vulnerable. Essential services should be targeted to people who suffered most from the crisis.

⇒ New "rules of the game"

Dialogue with prudence, justice and adequate listening to all stakeholders

Adaptation to the unique combination of short-term urgencies and long-term challenges requires to reconsider the prevalent "*rules of the game*". Some commentators even call for "*reinventing, rebalancing or complementing capitalism*" to make it more human and more inclusive. The wording stresses the systemic dimension of the present policy and regulatory endeavors. Financial institutions, products and mechanisms are not neutral and need to be reassessed in the context of these new realities.

New rules and regulations must be designed with prudence and justice, with adequate listening to all stakeholders, particularly those who will be impacted in the first place: the professionals but also, on the same footing, suppliers, clients, employees and workers with the preeminence for the weakest of them.

Governance and regulatory changes should be approached as fine-tuning processes, allowing stakeholders of good will sufficient time to adapt while combining – which is not easy – the top down and bottom-up flows of information. Such processes based on dialogue require adequate methods and fora where legitimate stakeholders – including Churches (COMECE) – can bring their contribution to the common good. Participation is a key principle of CST. However, peculiar attention ought to be paid to avoid "*regulatory capture*" of these processes by the strongest and most powerful vested interests.

⇒ Debt and tax

Necessary contribution to solidarity and more just distribution of resources

Ethical discussions around credit, debt and interest are not new. They are concerned with the issue of justice in sharing of risks and burdens. The same concern is part of present financing dilemmas. In situation of low interest rates, public debt seems to be the adequate – being the cheapest - instrument to smooth the burden of present additional spending across long-term time horizons. If debt is to be paid back, as implicitly assumed by many, this however involves committing future generations of citizens and taxpayers. Some scenarios count on inflation to alleviate the real burden of the debt. Inflation however, not to say straight future default, will impose a haircut on creditors – i.e. on those who provide today their savings, often household or pension funds, and thus future rentiers.

In this complex situation, a good debate – including moral dimension – is needed before taking the ultimate spending and financing decisions. Alternatives or accompanying measures should be carefully envisaged, including temporary and selective increase in taxes possibly on profits and revenues of capital, on wealth and inheritance, especially where thes taxes are low. Such moves would shift some of the additional fiscal burden from (future) labor revenues to (present) revenues of capital. This way of action would contribute to solidarity and a more just distribution of resources. The culture of more generous donation would also – if institutionally supported – contribute to a new culture of solidarity, so much needed today.

⇨ Make good use of the new EU own resources to promote inter-generational solidarity: The EU new sources of revenues ('*own resources*') will help to reduce the Member States' burden to repay the borrowed money needed to recover. A fair burden sharing is needed over time across the generations to recover, and the younger generation should not be left behind.

⇒ Preventing over-indebtedness, saving before credit

Safeguards for weakest as prevention of over indebtedness must be reinforced

Times of pandemic have increased the vulnerability of the already most vulnerable members of the social fabric, namely those who match with difficulty their living expenses. In many cases, the most distressed families (especially those in precarious condition) are also caught in a debt spiral. Adequate safeguards for the weakest, preventing them from sliding into over-indebtedness – which in certain situations can also have a criminal dimension – have to be reinforced in times of pandemic through adequate social policy response, namely by putting a cap on interest and related payments. More generally, in cases of proven unbearable debt situations, debt alleviation mechanisms involving private, public and civil society need to be strengthened or, put in place where they do not exist. [4] The ultimate objective being to pay due attention to the weakest and the poorest members of society by providing decent wages as to allow them to step out of the deleterious credit-debt spiral. Furthermore, credit to the weakest should be coupled with education in the field of disciplined budgeting and management of expenses.

⇨ The European Parliament and the Council should put forward the 30 June 2021 European Commission's proposal for a Directive to revise the 2008 'Consumer Credit *Directive* (2008/48/EC)' and ensure its full implementation in all Member States to reinforce consumer rights linked to consumer credit agreements, to raise more awareness to consumers on the risk of becoming over-indebted and tackle disinformation.

⇨ In the long-term, the EU should evaluate the impact of COVID on vulnerable consumers' credit behaviour to provide earlier, better, and more targeted support. Member States, financial actors, public agencies, and debt advisors should work closely together with people suffering from over-indebtedness to prevent them from the earliest stages from the risks of poverty or social exclusion and be ready to renegotiate the terms of the agreements if needed. The European Commission can help by increasing funding to enlarge the availability and quality of debt advice services in Member States (as announced in the New Consumer Agenda's *Communication*).

[4] https://www.humandevelopment.va/content/dam/sviluppoumano/vatican-covid19-response/doc-newsletter/economics/book/c-COVIDCommDebtFINAL2021.pdf

⇒ Credit or equity?

Which instruments are needed to survive the crisis?

An important portion of public rescue packages in EU countries are aimed at helping the most affected enterprises to survive the crisis. Different instruments can be envisaged in this respect from straight forward subsidy or publicly guaranteed credit lines to straight contributions to equity. In Europe, by and large, SMEs are endemically undercapitalized due to low level of equity on their balance sheets. The level of equity has probably further decreased because of losses incurred during the pandemic. In consequence, present rescue programs can be used in a selective way to reinforce the long-term weakness of SMEs' balance sheets. In this perspective classical debt, even if publicly guaranteed, should be balanced by setting up new financial instruments aiming at strengthening the equity component of balance sheets.

Such instruments will not pose more risks of cronyism and corruption than guaranteed credits. These risks could be mitigated by fair and diligent administration of funds and precise contracting. In parallel, relevant incentives might be designed for SMEs to create additional jobs. By strengthening equity of SMEs, public authorities would bet on their growth and future expansion of their employment bringing prosperity to the weaker segments of economic and social fabric, including the empowerment of emerging segments of circular and proximity economy.

> ⇨ Whilst helping enterprises who need it most seems a priority in the short-term, the present EU rescue packages should also be used to set up new financing instruments which would dynamically adjust debt service payments to the performance of the enterprise while allowing it to strengthen its capital base.

III. MESO DILEMMAS

⇒ Financial markets and banking union

Market integrity contributes to justice among market participants

Banking and financial markets unions are two parallel long-term projects that respond to the globalization of finance, but also – internally - change the allocation of competencies between the national and regional levels. This means that each of these unions potentially affects the existing subsidiarity and solidarity balance of risks and opportunities. These two projects should be pursued with greater attention to the weakest among their stakeholders, i.e. clients (persons and enterprises) and workers.

The GFC have shaken the unchallenged supremacy of the model of financial system where markets are expected to spontaneously provide, largely unattended, solutions to the problem. The privatization & commercialization of stock exchanges in late 1990, together with new technologies, resulted in growing fragmentation (competing platforms and black pools) of trades which, in turn, has put at risk the very integrity of the market. By doing so it has put in question its contribution to efficient allocation of capital across the economy. The projected financial markets union has to critically assess these innovations so as to protect the "*veracity*" of market prices, without which efficient market allocation cannot be achieved. Market integrity contributes to justice among market participants, which is one of the main concerns of CST.

⇒ Change in behaviors needed – “*care about care*”

Behaviours have to change at individual and at enterprise levels

Changes mentioned above will not happen by the sole virtue of better information, of better and new policies, laws or regulations. If the window of opportunity of the pandemic is to be used for the sake of a better future, behaviors have to change at individual and at enterprise levels.

The notion of “*care*” as a call to go beyond an efficient market transaction based on equivalence needs strong consideration: to care for the partner, the client, the supplier, the environment, the local community, etc. The call to “*care about care*” aims at fertilizing each market transaction or contract by embedding in it some elements of unilateral gift and by doing so to contribute to the dynamic of building together the common good of humanity.

⇒ Church’s finances and their management

Church institutions should not be left aside of the emerging “*rules of the game*”. This means that despite their variety and respecting their specific mission, Church institutions at all levels – from local to global - should provide public opinion with transparent financial information, audited by independent and recognized professionals, in line with the local and international standards.

IV. MICRO DILEMMAS

⇒ How to use savings?

Need for deeper and more evenly distributed financial literacy

The long-term prevalence of low interest rates de facto has (susp)ended the “*automatic*” risk-free multiplication of savings by the sole virtue of time passing. In consequence, the traditional bank-account savers search for alternatives: some prefer real economy investments (real estate, privately held enterprises, private equity or SMEs) to bank deposits while others, searching financial returns, are mechanically pushed towards financial assets other than public bonds, which carry higher returns but are also riskier. This situation has contributed to fuel the recent surge in share market prices, to levels unrelated to the performance of the relevant enterprises and economies. The economic and speculative factors behind this growth elements are difficult to disentangle, but they are both present. In this situation, the financial awareness of the saver as to her/his medium- and long-term financial needs is vital. Without such awareness – which extends beyond the sole financial literacy – the saver will have difficulties to define what is for him/her the right balance between fixed-income assets, such as bonds, private or public, and equity.

CST has often expressed its primary concern for the “*real economy*” as opposed to financial (speculative) investments. In the context of zero interest rates, savers need to thoughtfully consider alternative uses of their savings, keeping in mind their needs and the principles of CST.

To address these new situations and new client needs, finance professionals – including advisers employed by banks and asset management firms - will be expected to provide balanced and adequate financial information and advice. This may put them in situations of moral tension related to conflicting loyalties: on one side the interest of the employer on the other the loyalty to the client. These tensions will come on top of professional challenges already present in MIFID II. These tensions will not be fully eradicated by better – more transparent and meaningful – financial information, which however, remains urgently needed. In parallel, those segments of the population which until recently did limit their exposure to financial instruments to savings accounts and life insurance products need to urgently increase the level of their financial literacy to cope with the new situation.

The need for deeper and more evenly distributed financial literacy among the users of financial services is especially true in relation to digital devices supported by artificial intelligence, which use additional information and sophisticated algorithms to "*nudge*" the client by leading him/her to an outcome aligned with interest of the provider of the service. If not checked by adequate regulation and level of literacy, increased digitalization of products and services may induce new types of asymmetries or even of exclusions form the access to fair financial services.

Better financial education of the owner of idle savings has to accompany his/her awareness of the responsibility of financial decisions while high ethical standards of financial professions are needed in times of absence of returns on saving accounts, or risk-free public bonds.

⇒ ESG – the long road from financial assets to real economy effects

Three important hurdles of the validity of ESG objectives

ESG investment is today promoted by political discourse, by a number of NGOs and professional asset managers. The ultimate rationale of these efforts is to provide corporations which respect the environmental, social and governance principles in their daily operations with cheap and abundant resources so as to enable them to grow and expand employment. Their expected success is foresees a virtuous feed-back loop of imitation, performance and good practice. The cumulative awaited result is that of a better world tomorrow. The validity of ESG objectives is beyond discussion and it has to be taken earnestly. However, three important hurdles have to be addressed first before this perspective materializes.

First, today the great majority of ESG investments are made at the stock market level which means that they only affect the working of the real economy indirectly. Indeed, acquiring the shares of "*good*" companies is not tantamount to providing them directly with funds. What such a purchase stems – if it succeeds in pushing the share market price up - is to contribute to allow the enterprise to eventually raise additional equity capital cheaper than before. In consequence, only if "*good*" companies have abundant and sane (in ESG sense) real-economy investment projects and need additional equity capital, the ESG stock-market investment will possibly make a real difference.

Second hurdle is semantic. Today the terms of ESG play the role of an umbrella concept covering a variety of sets of criteria, methodologies and investment vehicles used to identify and reach the "*good*" companies. In consequence ESG refers to a fuzzy set of companies and to heterogeneous fiscal management techniques. This is the reason why, any fund, pension or asset manager (or owner) considering ESG investments needs, before deciding, to look carefully beyond the sole mention of ESG to check if the effective meanings that the specific service provider gives to that notion is aligned with his/her understanding of it. The importance of this effort to bring ESG into life, should not be underestimated. In this context, the efforts of the EU to provide a unique taxonomy – with a perspective of making it global – together with the efforts to embed ESG, are of utmost importance.

Third, responsible shareholding, which is part of any earnestly understood ESG investment strategy, requires active contact and dialogue with the invested companies. This dialogue requires, on the side of the asset holder, additional expertise which has a cost and risk dimension. These cost elements related to ESG have to be explicitly part of the financial investment equation by the fund's owner, and of any trustworthy investment advice. The success of ESG strategy also requires that the ESG concerns are part of the business model, incentive system and corporate culture at the investee company level.

Provide enterprises of the real economy with the adequate regulatory and fiscal framework to encourage them to expand while respecting ESG requirements: the minimal level being the 'do no significant harm' principle put forward by the EU.

- ⇨ Provide enterprises of the real economy with the adequate regulatory and fiscal framework to encourage them to expand while respecting ESG requirements: the minimal level being the 'do no significant harm' principle put forward by the EU.
- ⇨ The second recommendation related to the legal consolidation of ESG related definitions, is to establish a unique playing field, while preventing the notion from losing its meaning and traction.
- ⇨ Make full use of the EU Taxonomy and recovery fund to meet the climate objectives: The EU Taxonomy should be fully used to identify and align public and private investments to meet the climate objectives while recovering from COVID-19.

V. RECOMMENDATIONS

- ⇨ Reconsider, in the light of present societal needs and challenges, the metric generally used – at **macro** as well as **corporate level** – to measure, target and reward success.
- ⇨ **Corporations, providers of goods and services as well as of jobs** should keep their activity targeted on their contribution to the common good. They should care for the quality of products/services and their contribution to the well-being of customers, care for the dignified work conditions they offer to their employees and partners, care for nature and the environment.
- ⇨ **Regulators and lawmakers** have to care not on partisan interests but on putting in place "structures for the common good" and not "structures of sin"; to care about the delicate mechanics of markets, for guiding innovation where it contributes the most to the common good with special attention to the weakest and the marginalized.
- ⇨ **Universities and teaching institutions** need to move away from the silos approach, especially in fields of the so-called hard sciences – including economics and finance – so as to expose students to the ethical and philosophical considerations and be able to orient and give sense to their technical skills and knowledge from the beginning.
- ⇨ Systemic transformation is a **collective endeavour** which requires a critical reappraisal of habits and priorities **from all of us**. Care for the other should become central part of our daily life.