Introduction to the Special Issue on “Ethics, Global Finance and the Great Recession”

The global events of 2007-2008 have brought financialisation, namely the increasing role of financial motives in the operation of modern economies and societies, to the attention of millions of people, who are now questioning the neoclassical foundations of economic theory and practice. However, many fundamental questions are still unanswered. Will the actors, institutions, and policies of financial markets that led to the financial crisis and the related Global Crisis be tamed once and for all with new regulations? Would this require a paradigm change in the economics discipline and policymaking away from neoclassical models and assumptions? Furthermore, what is the proper function of financial institutions in the achievement of a fair society? What role should ethics play in shaping the behaviour of these institutions? Could the financial sector be restructured to enhance social and economic goals such that if a financial crisis occurs, as in 2007, its negative effects will not fell disproportionally on the most vulnerable parts of the society? These are complex and challenging questions. The papers in this special issue are an attempt to start answering these fundamental questions, and provide hints for policy-making to address future crises and their impact on the society at large.

The first paper by George DeMartino starts the special issue by tackling one of the key assumptions in neoclassical economics, namely the Kaldor-Hicks compensation test and its associated Paretian Guarantee. DeMartino shows that the Kaldor-Hicks compensation test serves as a theoretical justification for the harm that economists generate on the most vulnerable parts of the society. Here, harm is defined to include, inter alia, macroeconomic instability, financial crises, rising income inequality, ecological degradation and associated cases of mortality. The point made by DeMartino is that the Kaldor-Hicks compensation test makes the wrong assumption that all gains and losses are commensurable, and hence that they can be compensated for. Such framework is arguably defendable on the basis that, in the long-run, it leads to Pareto-superior outcomes whereby, as long as the winners retain a net benefit after compensation occurs, the whole of society benefits from short-run innovations. In other words, regardless of the welfare losses individuals experience in the short-run, as long as compensation can be made to the losers and still favour a few winners, the whole of humanity will be in a state of overall Pareto superiority in the long-run. However, the time
inconsistency is precisely where the problem lies according to DeMartino. Irrespective of its ideological underpinnings, economic practice induces harm. Any attempt to understand and possibly moderate the harmful effects generated by economic practice must start by moving beyond the neoclassical assumption that gains and losses can necessarily be compensated for. Economic practice may not necessarily produce a net benefit for the whole of society. Recent events are a point in case. Financial actors, institutions, and policies that have contributed to the financial crisis and the related Global Crisis have induced great harm to our societies, the effects of which fell disproportionately on the most vulnerable parts of the society.

Looking at the US context, the second paper by Bansak and Starr addresses the question of who has been mostly affected by the economic downturn and the house price bubble during the recent financial crisis. Bansak and Starr assess the relative loss in income and wealth of people mostly affected by the changes in house-market prices. Using educational achievement as a proxy for permanent-income, their empirical analysis looks at the changes in employment, homeownership, home values, and housing costs over time. As such, the methodology used allows us to understand the lasting impact of house-market prices on past and present economic wellbeing. Part of the results shows that low and middle-income households with relatively lower levels of education were severely affected by the collapse of house prices. These households face restrictions in economic opportunities with less potential capability for adaptation to changing economic circumstances. Such result raises the issue of welfare policy design and associated market regulation, which the authors argue would be most effective prior to the bubble bursting in order to protect the assets, and hence the future of the most vulnerable parts of society. Thus, before assessing the type and extent of compensation needed to protect the livelihoods of households, it is important to identify the parts of society mostly hit negatively by economic practice.

The third paper by Arestis, Charles, and Fontana also highlight the parts of US society strongly hit by the 2007 global financial crisis and the related Great Recession. The contribution of this study, however, is to place the issue of the harm generated on vulnerable groups in the context of the financialisation era since the 1970s, and the associated exacerbation of social stratification by ethnic, gender and occupational groups. Such long-term perspective enables the authors to place the impact of the financial crisis within the problematic nature of the power relationships between identity groups specific to the US society. They show the sustainability of the dominance of a homogenous group at the top of the social and organisational hierarchy, which goes beyond the financial crisis and associated
Great Recession. Whether the crisis has taught us anything new in terms of financial stability can be answered by the worsening fate of vulnerable groups in the balance of power between identity groups at the societal level. In effect, the study raises major concerns when the intersection of identities at the top of social and organisational strata creates a stable and homogenous ideal that can damage, not just the financial sector, but also the stability and sustainability of the real economy. Looking for criteria that create stable financial behaviour and practices, it requires a better understanding of both the long-term benefits of decision-making on all parts of the society, and the specific institutional environment in which economic practice takes place.

Finally, the paper by Grabel takes the issue of institutional heterogeneity to the global level and proposes a way forward in the global financial architecture. In effect, Grabel makes the case in favour of ‘productive incoherence’ in the sense that what seems to be incoherent in the way financial governance innovations blossomed in the aftermath of the crisis, especially in Eastern and Southern institutions, is actually productive for opening up new avenues for more sustainable and just forms of economic and social development. The argument put forward by Grabel is grounded on the work of Hirschman in terms of the importance of experimentation and improvisation in the pursuit of multiple development paths. Therefore, instead of implementing a grand utopian experiment universally, such as the homogenous and dominant neoliberal framework, Hirschman proposes to embrace change as an organic process in the development experience. To do so, one requires rejecting a dominant ideology, regardless of the origin of its grand design (eg. neoliberal or communist), and putting forward ‘Hirschmanian Possibilism’, where a variety of tools is needed to embrace changes, which are neither minor nor major, but real, uncertain and hence unpredictable. As such, while the rise of financial institutions in the post-crisis era is not proposed as an alternative to the Bretton Woods Institutions (BWI), it is rather advocated to be a possible safety net for countries whose financial interests are not in line with the dominant ideology serving the BWI’s policy purposes. Here, Grabel invites us to think about the possibility of a just financial system where the heterogeneity of financial interests needs to be reflected in the global financial architecture in order to embrace tomorrow’s uncertain changes, which can affect any part of the global society.

The lessons of the global financial crisis addressed by this special issue are two-fold. First, the harm generated by the neoliberal project is based on the flawed neoclassical assumption that all losses can be measured, compensated for and benefit the whole of society in the long-
run. Second, the time-inconsistency of this grand plan, whereby harm is legitimized in the short-run given its assertive positive implications in the long-run, is also flawed given that changes are uncertain, real and unpredictable. Hence, drawing a plan toward a fairer global financial system needs to start by embracing the heterogeneity of identities in decision-making and economic practice, at all institutional levels. By doing so, not only would we be able to address the needs of current vulnerable institutional groups, but also to set up an agenda where the needs of the society as a whole are addressed and protected. Such agenda would, therefore, enable us to embrace rather than fear the possibility that today’s dominant interests could become part of tomorrow’s vulnerable livelihoods.