November 6, 2009

"Building on Sand: The Economy and the Common Good"

William T. Cavanaugh

William T. Cavanaugh

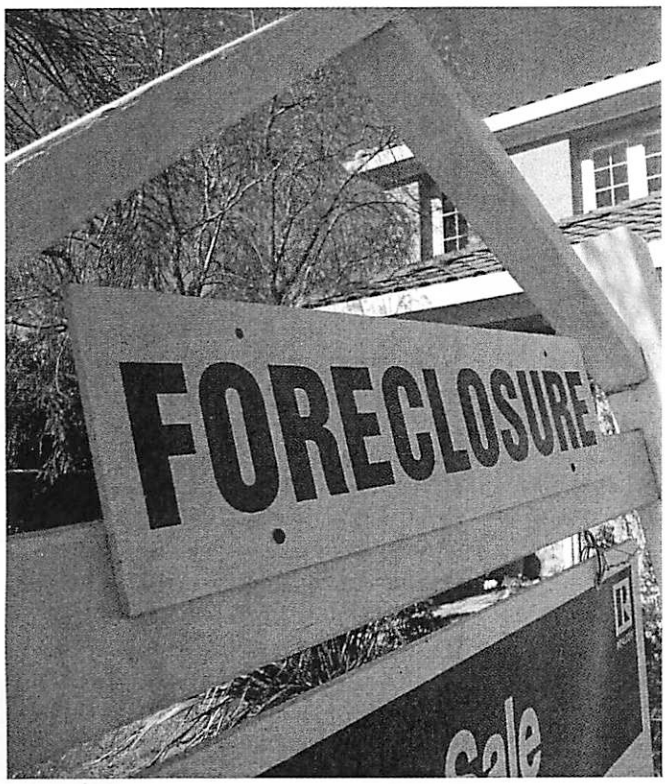
Building on Sand

THE ECONOMY & THE COMMON GOOD

Our economy is based largely on fantasy, a flight from reality that has led to a series of unsustainable economic choices and the crisis we are now experiencing. In contrast, the idea of the common good is based on a realistic understanding of limits, both human and economic. It is a concept that can help us understand and right our current situation.

The present economic crisis took off when high-risk mortgages were issued to homebuyers on the fanciful assumption that the "American Dream" of home ownership could be paid for by an inevitable rise in home values. Such a belief was not based on historical precedent. Rather, it was fueled by the demand caused by the loans themselves. To stimulate further demand, banks came up with a quick-and-easy means to pass along the risk associated with home lending by packaging and selling this high-risk consumer debt as securities called "collateralized debt obligations." Ratings firms like Moody's applied AAA designations to these securities, facilitating the process. The CDOs were then listed by investment firms, hedge funds, and banks as *assets*, and used as collateral to borrow more money. Money was being made on borrowed money, and debt was being used as collateral.

Traditionally, the idea of home ownership had been based on the slow accumulation of equity, as the principal on the debt was paid down, and on the relationship established between borrower and lender. Often a local banker sat down with someone in the community and assessed the borrower's real needs and resources before writing a loan. Furthermore, these banks were lending money that was backed up with real deposits. As we now know, much of this was jettisoned in favor of an economic fantasy.



RESPRES

Yet the fantasy grew. On the assumption that there must be a way to profit from all this new risk and insecurity, credit default swaps were invented as insurance on risky loans. This created a casino atmosphere where dealers bet on a company's chances of default. Whereas most forms of gambling are subject to some form of government regulation, these swaps were not. The only limit was how much both parties were willing to wager. Unlike conventional insurance, no cash reserve was legally required to back up such swaps, and people bet far more money than they actually had. The market in such swaps grew to $54 trillion by September 2008, more than the world's total annual economic output. When the bubble burst and house prices began to fall, the system imploded and the government had to step in to bail out the most reckless players with—what else?—borrowed money.

More than mere individual greed or materialism precipitated the meltdown. The deeper cause was a desire to be free of constraints—including, in the economic sphere, those of scarcity and risk. The concept of scarcity has always been central to

economics. Scarcity means that our unlimited desires have to come to terms with the reality of limited resources. According to classical economic theory, there will never be enough goods, resources, or services to satisfy all possible human wants. The recent financialization of the economy—where banking and credit markets became such a predominant part of the total economy—was an attempt to multiply wealth without any real increase in material production. It created profit for many in the finance sector, but without creating new value (real wealth) for society. This arrangement encouraged lenders to pass on risk to someone else as quickly as possible, rather than to establish a relationship of shared risk between lender and borrower. The system tempted some to fantasize that profit could be made risk-free, and that it need not be based on personal relationships or mutual trust. Traditional loans require such trust, but the newly invented transactions, such as credit default swaps, could be made between mutually suspicious parties, some of whom hoped to profit from others' defaults.

It remains to be seen whether government can help alleviate the worst excesses of the financial system. The government's main role has recently been as an enabler, deferring real accountability to some later time by borrowing money to absorb risk for the most reckless financial players—including major banks, Fannie Mae, and the giant insurer AIG. Catholic social teaching—based on the principles of the common good and subsidiarity—encourages not greater state-corporation symbiosis but a return to saner, more local economies—economies grounded in actual production and the meeting of people's needs. To be a finite creature of a good God is not a condition to rebel against, for in Catholic teaching, creation and material reality are seen as good. Rather, humanity's "fall" is an attempt to deny our creatureliness and dependence. It is evidence of our desire "to be like God," in the serpent's words (Gen 3:5). The root of sin is the avoidance of our creatureliness, whereas salvation means entering into reality—that is, into communion with God, with others, and with creation itself.

Wendell Berry has written that when it comes to solving the social, economic, and ecological crises, we should expect neither the state nor the corporation to save us. Our problems begin too often with the fact that we have already handed over our responsibilities to states and corporations. Corporations now produce most of our food, clothing, and shelter, whereas the state provides more and more of what individuals, families, and local communities used to take responsibility for. According to Berry, our major economic practice now is "to delegate to others." But faced with the present crisis, people and local communities must redirect their actions and economies. We should begin by discerning what is necessary for our real health and well-being. This means acknowledging our dependence on one another and sharing risks; being attentive to the accumulated wisdom of local knowledge as it relates to the environment; reestablishing direct relationships among producers and consumers wherever possible; and encouraging everyone to become producers—by gardening, baking, making furniture, etc.—rather than simply passive consumers. Instead of handing over money to an impersonal, destructive financial system, we need to put it to work locally, through credit unions and co-ops that can make realistic assessments of debt and risk. In an economy based on the common good, borrowers and lenders will not only acknowledge their dependence on one another, they will reclaim and own it. ■

William T. Cavanaugh *is professor of theology at the University of St. Thomas in St. Paul, Minnesota. His most recent book is* The Myth of Religious Violence *(Oxford University Press).*