

The Dublin Process

Ethics in International Business and Finance

Fondazione Centesimus Annus - Pro Pontifice

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An Ethical Debate on Finance and Technology

Purposeful innovation in Finance

A response to the paper by Dame Helena Morrissey – by Jason Channell

Much of the paper to which this text forms a response relates to inequality, and the associated factors of disillusionment, disengagement and the sense of marginalisation being experienced by many. For many, a real perception exists that leaders, politicians, policymakers and those characterized as the 'elite' are not listening to the broader population, which increases the sense of frustrated marginalization. The trait of 'I know better' is not limited to the elite but manifests itself across many areas of society — such as the controversial policy of 'no platforming' being witnessed at some universities in the U.K. This provides an example of a perhaps increasingly intolerant and selfish society — which highlights the importance of values in society and the importance of the dignity of, and respect afforded to, the individual.

Inequality is a hugely important topic and one that we examined in great detail in our recent report written in conjunction with the Oxford Martin School: [Citi GPS - Inequality and Prosperity in the Industrialized World](#). Inequality within countries has indeed risen markedly in recent years, as has inequality between generations, regions, and even companies. As we observed in the report, inequality matters economically because countries with greater levels of inequality often grow less fast than more equal countries, and there is reason to believe that growth is also more fragile. Inequality leads to declining social trust, the erosion of social cohesion and degradation of the political processes via lower electoral engagement, and it has even been linked to poorer health. Inequality also appears to be self-perpetuating, with the significant correlation between intergenerational mobility and the GINI coefficient implying a lower level of social mobility in less equal societies, again a key factor in the perception of equality and opportunity, which can be so important to an individual's sense of self-esteem.

As always, however, beneath the headlines, the detail can sometimes paint a different (though less attention-grabbing) picture. It is important to draw distinctions between income inequality and wealth inequality (typically defined as the share of aggregate wealth owned by the top 1%), as the latter is typically more unequally distributed. The U.K. actually has, in a relative sense, an intermediate level of wealth inequality, despite having relatively high income inequality, while the reverse is true for Germany and the Netherlands. It is also worth noting that wealth inequality was substantially higher in the early 20th century in many economies than it is today. Alvaredo et. al.¹ estimated that the share of the top 1% in the U.K. may have been as high as 70% in the early years of the 20th century and was still about 45% mid-century compared to around 20% currently. Moreover, in contrast to most developed countries, U.K. income inequality as defined by the Gini coefficient has actually declined since 2008, which flies in the face of the popular perception. However, regional and intergenerational inequality has risen, and it is this (along with other factors, such as wage growth) that is potentially more likely to be what is being 'felt'. Whatever one's view of this complex subject — facts or semantics — the key point is that the belief of inequality is there and forms a key element of the sense of not being listened to and of frustrated marginalization. It is also worth considering the extent to which our ever-more connected world is a factor in the cementing of concepts into perceived wisdom and ultimately accepted realities. We do not intend to reproduce the wealth of detail contained in our Citi GPS inequality report in full in this limited response but highlight it as a source for further reading.

It is all too easy to lay the blame for the increase in inequality at the foot of globalization. However, as the Centesimus Annus Encyclical of 1991 effectively points out, globalization, if monitored, can be an enormous source for good. Indeed, while inequality within countries has generally increased, global

inequality (and inequality between countries) has declined since the late 1980s and particularly rapidly from 2008 as developing countries have closed the gap with developed countries. This is a direct reversal of the trend from the early 19th century to the late 1980s, when global inequality consistently increased. It is impossible to delink these more recent normalizations from the effects of globalization, which has, in hand with technology, arguably driven the most accelerated period of collective 'progress' in history. Since 1990, the number of people living in extreme poverty, on less than \$1.90 per day, fell from 1.9 billion (35% of the population) to 836 million (11%) by 2015, despite the global population rising by 39%, from 5.3 billion people to 7.4 billion, over the same period.

But enormous challenges remain. More than a quarter of the world still lacks access to clean water, while a third of us — some 2.4 billion people — lack access to basic sanitation, and a billion people lack access to electricity. Undernourishment affects 815 million people — more than one in ten of us go to bed hungry each night, while one-third of all food produced is wasted. Forty percent of children under the age of 14 (770 million) still lack access to a full education; aside from the obvious impact that a full education might have on their own lives, what impact might almost another 1 billion well-educated people have on the global economy, on the eradication of poverty, and on all the associated implications for conflict around the world?

With that backdrop, we bring this paper around to two of the key issues — finance and technology — to be discussed as part of the Dublin Process convened by Centesimus Annus Pro Pontifice in January 2019 and to which this paper forms a submission.

Technology can be an enormous force for positive progress, greater inclusivity and reduced inequality in the world. Mobile banking and financial technology (fintech) have the potential to lift millions out of poverty, for example by including the 2 billion people around the world who remain 'unbanked', which can easily lead to their exploitation at the end of long global supply chains. New on-line educational models have the potential not just to address some of the issues raised above but also opportunities for adult learning around the world and for re-training/re-skilling, which is likely to be a necessity resulting from the longer-term impacts of greater adoption of automation and AI on employment models, as we examined in our [Technology at Work](#) Citi GPS series. Alternative energy brings enormous potential for distributed generation and social and economic advancement. But none of this progress can be achieved at any scale without the finance to facilitate it.

If globalization has been a key player in that enormous progress achieved since 1990, then finance has played a critical role in facilitating globalization. If applied correctly, with the correct moral compass, finance can be an enormous force for good. This brings us back to the key concepts of the original *Rerum Novarum* Encyclical of 1891 — that profit in itself is not a bad thing, whereas deliberate, exploitative profit at the expense of someone else may be morally unacceptable.

Finance can play an important role in social development, and recent developments in the finance industry provide enormous cause for optimism. Socially Responsible Investing (SRI) originally grew out of faith-based investor groups that were unwilling to invest in industries such as alcohol, tobacco and armaments. While initially a very small part of the investment world, 2018 was the year that saw the broader concept of Sustainable Investing move very much into the mainstream. The signatories to the UN-backed Principles of Responsible Investment (the PRI) — who have publicly committed to integrate ESG (environmental, social and governance) factors into their investment processes — now have combined assets under management (AUM) of some \$83 trillion, a similar figure to one year's total global GDP. While not all of the AUM of those signatories will be ESG funds per se, the amounts that are now estimated to be directly ESG screened or managed are about \$30 trillion in equities, with a similar figure in credit.

This provides the perfect example for the Dublin Process discussions of how religious teaching, values and practice can lead by example and provide a moral compass that the world, in time, may come to adopt more widely.

It is correct, as Dame Morrissey's original paper observes, that some of these assets may be paying lip service, but our broad experience in speaking to investors around the globe suggests that these are in the minority. The root of this fundamental shift lies in the changing attitudes of the ultimate asset owners — and asset managers are simply moving to reflect this. This shift could best be described as an increasing focus not just on the quantum of financial returns but on how those returns are made.

Whilst in the past it might have been possible (albeit not ethically or morally responsible) to exploit either the physical or human resources in a supply chain based in some faraway corner of the world, our

technologically and social media-connected world now makes it much harder for corporations to hide the skeletons in the closet. More fundamentally, consumers care about how their food is reared, grown or caught, and they are willing to pay premiums for healthy alternatives or for products that are sustainably sourced. Supply chains are paramount to brand perception, to pricing points and to consumer propensity to buy. Utilities are moving away from carbon-intensive generation, not least because of an inability to finance carbon-intensive fuels, while the transportation industry is undergoing its own evolution. The packaging and plastics industries are facing what could genuinely be couched as existential questions. In addition to increased environmental and social focus, all around the world, from Europe, to South Korea to Japan, we are seeing an equally dramatically increased focus on corporate governance, on stewardship codes, on diversity and on inclusion. The finance industry is facilitating these trends by developing new products, such as green bonds and social bonds, whereby the payment or quantum of a coupon can depend on the achievement of certain socially oriented goals. In Australia, the concept of universal ownership has taken root, in recognition that some of the Australian Superannuation Funds are such broad owners of assets that they are a systemic player and have not just a vested interest but also a responsibility to help to guide the overall economy in societally optimal directions, towards a sustainable future.

This last point is perhaps the most critical of this response. Large parts of the financial world have now woken up to the fact that whilst a short-term profit may have attractions, a model predicated on a resource running out — or at worst on an exploitative approach or where returns are unsustainably high — is highly likely to go out of business or ultimately be regulated out of existence. The recognition that a more sustainable business model that is fit for the longer term may be significantly more valuable surely must be viewed as a purposeful, positive innovation in finance. Moreover, the increasing awareness of the 'social license to operate' amongst corporates could be argued to reflect a much greater focus on moral values and ethics in business and finance, very much in line with the broader concepts discussed in the original 'Rerum Novarum' of 1891.

Moreover, there is a growing understanding that ESG factors are financial factors and that all of these issues — from selling prices to volumes, operating costs, financing costs, tax rates and funding sources — are inextricably linked with ESG, reflecting an encouraging symbiosis between financial and societal returns.

But it is more than just not wanting to be associated with 'bad' things. An even greater cause for optimism comes from the rise in impact investing and the important concept of 'additionality' — i.e., the additional positive impact that a particular investment has made on achieving an improvement in a sustainability-related metric, as opposed to being merely aligned with it. Investors increasingly want to demonstrate a positive impact from their investment and are encouraging companies to report on the impacts of their own operations, both positive and negative. It is typically hard for investors to demonstrate additionality purely by buying a listed equity from someone who has sold it. However, additionality can be demonstrated via engagement, which brings us back to a more basic question of "what is investment?"

Is it simply trying to be slightly smarter than the next investor to gain a return, or is it trying to invest in a business and helping that business to grow and outperform? (This chimes well with one of the key points from the Centesimus Annus Encyclical of 1991 regarding whether a particular type of work actually adds value to the system.) Again, a greater level of active engagement with business managements to achieve more positive societal outcomes and more sustainable business models (and yes, ultimately higher financial returns) is surely a good thing, which flies in the face of our fears of an increasingly disengaged, selfish and intolerant world.

Conclusions

So in a society where values and ethics may appear to be overshadowed by the clouds of selfishness and intolerance, we believe that significant sources of optimism can be found in recent innovations in finance, suggesting an increasing recognition of the need for a balance between financial and societal returns.

The benefits of globalization are clear, but we need a balance of globalization and localization. We should try to eschew the short-term win, embracing instead the longer-term, more sustainable and ultimately more valuable option. Success and better communication of longer-term goals and plans have an important role to play. Regulation also clearly has an important role to play, but we must be careful not to

over-regulate and stifle innovation. Personal responsibility and a focus on ethics and moral compass must also play an important part, as highlighted by other papers written for the Dublin Process.

We should consider our investments in a broader context, recognizing their impacts, both positive and negative, and being mindful of feedback loops. We can adopt frameworks to align our investments with societal goals, as an increasing number of investors are aligned with the United Nations Sustainable Development Goals, an issue examined at length in our report [Citi GPS - UN SDGs: Pathways to Success - A Systematic Framework for Aligning Investments](#). The increasing levels of disclosure provided by Corporate Sustainability Reports, and efforts such as the Task Force on Climate-related Financial Disclosure (TCFD), play an important role, as do initiatives to standardize sustainability reporting, such as the Global Reporting Initiative (GRI) and those by the Sustainability Accounting Standards Board (SASB). Organizations such as the PRI can also play a critical role in purposeful financial innovation as well as drive systemic change. Investors should continue to increase their levels of engagement on the topics raised (and importantly not raised) in these reports and should demand greater levels of transparency, so that they are truly aware of what they are investing in and the implications of that investment, especially if they wish to claim additionality. Other measures could also help to reduce short termism – such as the view held by many that quarterly reporting adds little and can indeed take a company's attention away from longer-term goals to focus on maximizing shorter-term results.

Finance can — if done in a longer-term, responsible, ethical and moral manner — facilitate so much positive progress globally, and financial markets and financial innovation have the potential to align the trillions of dollars that investors want to invest sustainably with the vast need for investment around the world. We have an individual and a collective responsibility to address the myriad of sustainability and ethical-related challenges in the world today, and if we do so successfully, the rewards, both societally and financially, are inestimable.

ⁱ Alvaredo, F., Atkinson, A.B., and Morelli, S. (2017). The challenge of measuring UK wealth inequality in the 2000s. *Fiscal Studies*, 37: 13-33.