

SURF 4: The Financial Crisis

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There are two separate articles here, but they are to be related by the beginnings of a perspective on global functional collaboration shared by us and by you. The degree with which it is shared by each of is to be a topic of the next few SURFs. But, presuming that you at least know the list of the eight specialties, then you get some idea of the relation between the two when I say that the first article, mine, is a stumbling shot at Functional **Research** and the second article, by Eileen de Neeve, is an effort to meet a requirement of the functional specialty **Communications**.¹

A shabby beginning, then, of an effort long overdue. Imagine, fantasize about, a more mature community of collaborators. Then we would have here, not two articles, but a culture of collaboration in economics and culture with articles within each specialty in journals to some extent identifiable by functional focus.² For the moment visualize six other sets of articles between my article and Eileen's. As we move forwards in our efforts both to fantasize and to collaborate, we should progress in this visualization. What, for instance, would a foundations of economics article look like, now or in a hundred years?

But I am not going further with this problem here. It is sufficient for the present that you are willing to come with me in my effort of research, noting what leads that I suggest should be followed by you or by the culture: followed, within functionality, by interpreters, historians, etc etc. The functionally-followed leads, interpreted, contextualized, corrected, twisted foundationally and doctrinally towards the future,

¹See *Method in Theology*, 132, under (8), for the kinds of external relating involved.

²This is a complex issue to be met later. Functionally structured disciplines will slope towards each other and towards a common foundations, so we are to expect a dialectic and foundational literature that is omni-disciplinary. On the sloping see "An Asymmetry of Slopes", chapter 7 of my Website book, *Method in Theology: Revisions and Implementations*".

broadened into a geo-historical genetic systematics, would - with a lag - be a rich zone of selection by the functional specialists of communication.³ Eileen's effort here does not have that back-up. Instead, we had some few discussions of our work, especially in the context of her recent book. Eileen, then - to use the image I introduce shortly - is in her village where the mood and the erudition are against her getting a hearing. But what if there were 10,000 like her, in 10,000 villages, backed up by "the turn to the idea"⁴ that is the idea of functional collaboration? Would there not be a slight but noticeable discontinuity in the statistical distribution of efficiency⁵ as opposed to effete⁶ness in the idea's twining with history's molecules? Can we expect more in this early millennium of the stumbling human spirit?

³See Philip McShane, "Systematics, Communications, Actual Contexts", Lonergan Workshop 7(1987), reproduced as chapter seven of *ChrISt in History*, a Website book. We need powerfilled fantasy in the context of the image of 10,000 villages, to be developed presently in the first article, and the lag-spreads of their mesoeconomic needs.

⁴Relevant here is Lonergan's paralleling of doctrinal development with various economic systems in note 10 of page 10 of *De Deo Trino: Pars Dogmatica* (Gregorian Press, 1964). There he gives his free translation of Simmel's *die Wendung zur Idee*: "displacement toward system". The system he finally reached is a global anti-foundational cyclic system of functional collaboration. "Displacement towards"? The displacement towards system is, in its ultimate goal, an eschatological displacement into the System Spoken and Heard in God.

⁵I recall my oft-repeated reference in this matter: *Topics in Education* 160, line 16. A science gains unity (and beauty and truth) from its efficiency. So "it is quite legitimate to seek in the efficient cause of the science, that is in the scientist, the reason why a science is a unified whole."

⁶"The better educated become a class closed in upon themselves with no task proportionate to their training. They become effete" (*Method in Theology*, 99). Place Lonergan's discussion of culture and Cosmopolis in the context of this page in *Method*. The leap of *Method* places culture within the *Praxisweltanschauung* of the Cosmopolis of functional system, and the task becomes unequivocally a shared pilgrim and eschatological care for the cosmos and its seven billion pilgrim residents.

The Global Financial Crisis

Philip McShane

The issue concerns all of us at present, and for those with some knowledge of Lonergan's work in economics, the question emerges, What would Lonergan's position lead to in this situation? The question, of course, has often the naivete of a desire for a swift answer. There is none. Still, some answer can be given.

What I would like to do is have us place that answer in the context of an incipient view of global functional collaboration. To do that I use an image of 10,000 villages, borrowed from Gandhi, that enhances Lonergan's 1942 suggestion about a generalization: "it will retire the brain trust but it will make the practical economist as familiar a figure as the doctor, the lawyer, or the engineer; it will find a new basis for finance."⁷ Our problem is to image more concretely the collaborative structure that is to be the community of functional specialists in later centuries. So, I ask you to envisage a community of 22,220 people, 11,110 facing the past and 11,110 facing the future: there would be 10,000 researchers, 1,000 interpreters, 100 historians, 10 dialecticians, and on through the other specialties to reach the 10,000 working in communications.

One of the advantages of such suggested imaging is that it helps to cherish, on various levels, the gap between the present and the future. In the imagined situation Lonergan's economist in the village becomes two economists, both working within the functional team, but one with an eye on detecting oddities, anomalies, that are in the present goings-on of the village. He or she is interested in both types, good or bad, in order to pass on, to the expert interpreters, questions about encouraging the good and discouraging the bad. Let me think of myself in that role in what I do here: so, my role is that of researcher. The other economist is at the other end of the cycle of collaboration, with an eye on the future and with expert backing. Realistically, of

⁷*For A New Political Economy*, 37.

course, the two are in conversation, which can lead to short cutting: but let us not go there for the moment.⁸

Let us focus on my doings, as researcher. I will here be doing, as we shall see, some rambling research that is ordered, functionally directed, to the non-existent group of 1000 Lonergan interpreters. Research, in its maturity, will be a set of operations luminously controlled, so the rambling that I do here must include self-appropriation of the rambler as researcher.

It seems worthwhile, indeed necessary, to bring to your attention that the competent researcher in any area needs to be up-to-date in that area's theoretic perspective. My analogue here is regularly the sharing of the Standard Model and its concrete achievements if one is a researcher in physics. So, if one is to discover positive or negative anomalies in the concrete operations of economics, one had best be tuned into the best of theory and of its implementation. For me, of course, the best of theory is Lonergan's amazing early achievement as expressed in the writings gathered in volume 21 of his *Collected Works: For a New Political Economy*. And the mention of that volume gives me an opportunity to illustrate the point at issue here.

Whether one is researching the scattered economic writings of Lonergan or the scattered - might I say scatty? - goings-on expressed in present learned economic journals or limping journalisms, one's success pivots on one's competence in best *Praxis*. So, for example, I brought a hard-won competence to the mess of Lonergan's notes on economics of 1943 in my effort to shuffle the incomplete collection into shape.⁹ What I bring now, in my new role as functional researcher, is an altogether more mature

⁸One has to envisage the concrete reality of conversations between all specialists, and such envisagement is greatly helped by symbolism. So, here, we have a conversation C₁₈, between the two specialists in Research and Communications: see note 35 below.

⁹The effort goes back to 1968, when Lonergan asked me to find an economist, and sent me the 1944 typescript. Through the 1970s and 1980s that 130 pages was a very regular focus of my attention.

theoretic competence that includes fantasy on implementation and facts on failure of implementation contextualized by that fantasy.¹⁰

The best I can do here, however, is light-weight descriptive foundational pointing towards work to be done. My task here, with many of my readers, has the added complication of being a foundational effort to tune people into, and turn people towards, a beginning of a search for competence. In the mature cycling of, say, A.D. 2111, my effort would be simply the tuning and turning of people to some fresh anomaly. The helpful element is to think now of my function as researcher handing on the anomalies to the group of 1000 interpreters. In 2111 the anomalies are to be picked up by the interpreters as a nudge to improved interpretation. Here the nudge is towards setting out on the difficult road of acquiring competence. I simply do not have 1000 interpreters competent in the general and special categories enriched by economic competencies. As a community we have to face that deficiency honestly and cunningly.

An odd analogy may help. I write of “Lonergan’s Standard Model” but it is obviously not standard in 2008. What is standard in my analogy, funnily enough, is a string theory. “Some young string theorists have told me that they feel constrained to work on string theory whether or not they believe in it, because it is perceived as a ticket to a professorship.”¹¹ Even in respected centres of Lonergan studies there is little

¹⁰One can think, for example, of the feedback from up-to-date Communications, which works with the same foundational mindset of competence and fantasy, but the issue is quite complex e.g. there is the cycling of contra-factual history that continually renews the probability recurrence-scheme elements surrounding the actual. The consideration of that renewal is very much additional fantasy at this seedling stage of functional collaboration. Realistically, most of my present readers have little grip on distribution functions: I must ramble along then in the text in a pedagogical modification of *haute vulgarization*. That is quite a different ball-park from the competence symbolized by a $UV + GS + F_i$ to be shared by the functional collaborators. Symbolism is not very welcome in contemporary theology, but it cannot be avoided if we are get anywhere. See P. McShane, “Obstacles to Metaphysical Control”, *Method: Journal of Lonergan Studies* 23 (2005). See, further, note 35 below.

¹¹Lee Smolin, *The Trouble with Physics. The Rise of String Theory, the Fall of a Science, and What Comes Next*, Houghton Mifflin, Boston, 2006, xxii. I would note, as a useful aside

effort to push towards the Standard Model in undergraduate or graduate studies: instead there is a stringing together of what is largely dated comparative work. So - attending to Smolin's subtitle - theological string theory rose considerably in the twentieth century; there was no science to fall unless we are thinking of Lonergan's neglected patent-office minding; and so we must ask ourselves 'What Comes Next?' The patent-office-work, in both cases, warranted massive discontinuities.

But let me focus here on what I would hope are smaller discontinuities available to us that relate to descriptively-observed anomalies.

Since the summer of 1977, when I presented twice - both in eight hours! - the content of Lonergan's 1944 economics, I have been mistaken in doing so. In the autumn of that year, when I was puttering round in libraries looking for books that might be relevant to Lonergan's first teaching of his economics in the Spring of 1978, Lonergan welcomed me into his room one day with a smile and his delighted decision about what to do with the class: "I am going to read the manuscript at them twice!" Now, in contrafactual hindsight, he too was mistaken. Moreover, the mistake blossomed over the next years - but the attitude in questioners was there all along - into class-questions of comparison, such as "How would Lonergan's view of Euro-dollars differ from the current one?" Only slowly did I learn from my mistake. Had Lonergan and I settled to making the basic point of his analysis then and in the years since, might there not be a sub-group now capable of talking to, or against, the present mythologies of bail-outs etc? Or might some economists have noticed, even from the 1940s on, the idiocy of a fundamental mistake in the selection of variables?

The fundamental mistake - but it takes a few first weeks of a course in proper economics to begin to ingest it - is to clumsily merge the two flows of consumer and producer goods into a phlogiston-type of economic base, and to follow that clumsy mess with quite unwarranted refinements of statistics. The tragedy of the twentieth

here, that this is not a recommendation of Smolin's recent book. It fits in with the present abundant output of unwise muddled popularizations.

century mess was that Lonergan, in his patent-office, was quite clear on all this phlogiston-application when he put together his 1942 typescript. But, like Einstein, he pushed on to solve aggregates of problems, and this in an increasing compact manner.¹²

Yet a compact recollecting of his magnificently clear “Why? What? How?” should help, or at least astonish. The issue, then as now, was the issue of “readaptation of the whole existing structure,”¹³ through a scientific generalization that “makes a new beginning.”¹⁴ What of the mess, then and now? The economists and politicians resist “moving to the more general field”¹⁵ and insist stupidly on “staying on the same level of generality and making up for lost ground by going into more particular fields of statistics, history, and a more refined analysis of psychological motivation and of the integration of decisions to exchange.”¹⁶ So we have had a century of scientifically-obscure statistics and expectational analyses.¹⁷

What was Lonergan asking for? “We are asking for an instrument that democracy must have, for it is the broad generalization, the significant correlation, that

¹²“Toward the end of his life he wrote in a spare and lapidary style that makes every word count.” (Charles Hefling Jn., in the Preface to Volume 15 of the *Lonergan’s Collected Works*, xix).

¹³*For A New Political Economy*, 6.

¹⁴*Ibid.*, 7.

¹⁵*Generalization* is a tricky word in Lonergan, with a complex history. For our purposes here, best to think of it as tied in with a concrete heuristic of cosmic goings-on: the heuristic would put the metaphysics of *Insight* in a functional context. That concrete and foundational heuristic is to be refined as we move along. So, for instance, local and global analyses (see notes 35 and 46 below) will lift the simple analysis of rhythms of productive and consumer expansions into something that parallels the Fourier analyses of complex overlayings of rhythms.

¹⁶*Ibid.*

¹⁷See note 15 above. The proper consideration of statistics and expectations needs this context. On the gap between present muddling analyses of expectations and a democratic expectational analysis see *Pastkeynes Pastmodern Economics: A Fresh Pragmatism*, 155-162, “The Hodics of Rational Expectations”. See also the next note.

effectively organizes free men without breaking down their freedom.”¹⁸ But the broad generalization is a massively concrete heuristic, and “it does descend to familiar things in quite an unfamiliar fashion.”¹⁹ Let me immediately illustrate that descent in a manner that nudges towards an essential feature of the present mess.

Best just quote myself, quoting Schumpeter. There is the familiar world of credit. A recent cartoon-video begins with a British economist (speaking to an inquiring journalist) loftily talking about the credit-monger approaching an old man on the stoop of the shabby building in which he rents. “I say, old man, would you like to own this building?” The credit monger gets his commission: the bad loan climbs into the mystic heights of packaged stupidity. Think, then, of the unfamiliar that Schumpeter writes about:

“Banks are not there to ‘force their money on people,’²⁰ nor ‘do they congratulate themselves if they are *loaned up*.’²¹ A banking committee is not ‘an automaton’ but understanding and attentive to purpose and situation, ‘judging the chances of success of each purpose and, as means to this end, the kind of man the borrower is, watching him as he proceeds ...’²² ‘It should be observed how important it is for the system of which we are trying to construct a model, that the banker should know, and be able to judge,

¹⁸*Ibid.*, 7-8. Here is wish to draw attention to a central point that demands tremendous efforts at fantasy: democratic rational expectations are to be locally creative. It involves, and cultivates, a mind-set that is not cultured or beaten into waiting for charismatic presidents or bureaucratic pundits, but one which sees and seizes micro- and meso- opportunities to improve the human lot. This is far from the present dominant mind-set of either capitalist or socialist cultures.

¹⁹*Ibid.*, 8.

²⁰Joseph Schumpeter, *Business Cycles*, Volume II, 640. I am referring in these notes to his two-volumed *Business Cycles: A Theoretical, Historical, and Statistical Analysis of the Capitalism Process*, McGraw Hill, New York and London, 1939.

²¹*Ibid.*, 641.

²²*Ibid.*

what his credit is used for and that he should be an independent agent. To realize this is to understand what banking means.²³ 'The banker's function is essentially a critical, checking, admonitory one. Alike in this respect to economists, bankers are worth their salt only if they make themselves thoroughly unpopular with governments, politicians and the public. This does not matter in times of intact capitalism. In the times of decadent capitalism this piece of machinery is likely to be put out of gear by legislation.'²⁴ ²⁵

In *Economics for Everyone* I talked about the going out of gear in 1968 with McNamara as head of the World Bank,²⁶ but the mess is older. Let us not get into that: more broadly, there is the worth for us of pausing over the unfamiliar as I capture it regularly in the Irishism, "Well, now, I have to give you credit for that!": there you have an old and unfamiliar meaning of credit and promise. But what have we in its stead, tumbling forward into subtle stupidities and cupidities in these last decades?

It is important to advert to what we are about here: I am giving popular hints of what a research community of 10,000 would cycle up to and beyond 1,000 interpreters in a mature functional collaboration. But that maturity would shift effectively the statistics of stupidities and cupidities. It is not present now. It could well have been present in a pre-Keynsian world had the economic community taken seriously Schumpeter's pre-WW I work, *Theory of Economic Development*. It could well have been present had Lonergan's 1942-4 work found an audience. But the present situation is the

²³*Business Cycles*, Volume I, 116.

²⁴*Ibid.*, 118.

²⁵Philip McShane, *Pastkeynes Pastmodern Economics. A Fresh Pragmatism*, Axial Publishing, 2002, 125.

²⁶"McNamara came from big business and bombing to banking. In 1968, the Bank's annual borrowings were \$735 million, the cost to the Pentagon of a few F-!!! fighter bombers, or less that a mount's fighting in Vietnam. So Mr.McNamara plunged forward, thinking in billions, not millions." *Economics for Everyone*, Axial Publishing, 1998, 116.

result of a phlogiston-economics meshed with greed and government and gushers.²⁷ We are asking the same questions as chapter one of *For A New Political Economy*, but our “What? How?” are now in the new context of the possibility of global functional collaboration: globalization is a reality and functional collaboration is an idea. We are asking **HOW** it is going to work, and the question must be faced existentially by a community searching for a collaborative structure of effective implementation, a structure of which Lonergan offered a vague idea..

Before going on, we would benefit from some better popular glimpse of aspects of the credit mess, and fortunately my work has been done for me in a sufficient manner for that glimpse. So, I point you towards three pages of *The Economist* of October 18th 2008: pp.79-81 is “a short history of modern finance.” It should be relatively easy to find. No author is listed, so I suspect that it is a group editorial effort. You might back it up by venturing into Wikipedia or some such, to get beyond short descriptions and namings, for example, of hedge fund operations,²⁸ or of credit-default swaps.²⁹ What might I add by way of hints? Chicago is in there with Friedman’s silly

²⁷“The static phase is a somber world for men brought up on the strong drink of expansion. They have to be cured of their appetite for making more and more money that they may have more money to invest and so make more money and have more money to invest. They have to be fitted with a mentality that will aim at and be content with a going concern and a standard of living. It is not an easy task to effect this change, for, as the Wise Man saith, the number of fools is infinite” (*For A New Political Economy*, 98).

²⁸I can only refer the beginner to elementary sources here, such as the *Wikipedia*, where there is a comprehensive 20 pages on the topic. We are talking about a pool of largely unregulated capital of several trillion dollars, juggled with by magnificently paid {both in management (maybe 3% of the total) and performance fees (at least 20% of the take)}. The ten top earners (an all- male list) are up there in the billion-dollar world.

²⁹A Credit default swap (CDS) is a contract in which the buyer of the CDS makes a series of payments to the seller, where the payments are related to the possibility of some bond or loan defaulting. So, an annual payment of \$500,000 can earn, on default, \$10 million. This is a pretty complex gambling business. Again, I can only refer the beginner to the 14- page account in *Wikipedia*. The pricing and valuation problem is regularly locked into a dubious horse-racing model of probability: on the dubiousness see my *Randomness, Statistics and Emergence*, Gill,

view of profit and the Black-Scholes formula for option-pricing. And instead of that unfamiliar intelligent notion of credit there is “easy money policy”, “cheap loans”, “slacker lending standards,”³⁰ “risk-spreading”, “packaging,” loosened structures of securitization.

“While all this is happening, regulators were not wholly passive. They had to deal with crises such as the failures of Drexel Burnham Lambert, which dominated the junk-bond market, and Baring Brothers, a British bank brought low by a rogue trader. But these were regarded as individual instances of mismanagement or fraud, rather than as evidence of a systemic problem”³¹ And the deep crisis is that envisaging a systemic problem - indeed, a massive systematic problem - much less conceiving of its character and the character of its solution, is quite beyond present economists and present governments. We are, no doubt, to have a new Bretton-Woods gathering, groping learnedly in the dark.

Let me now plunge forward to some points regarding suspicions of the systemic flaws. But please struggle - and it is a struggle, one of difficult fantasy - to hold the basic searching perspective that is driving force of this project. We are, together, trying to envisage the heuristic of a non-existent standard model of effective global functional collaboration. I am somewhat ahead of you, like the one-eyed king in the kingdom of the blind. We are in the zone described by Lonergan in his mistakenly-brief treatment of research. “One has to find out who and where there is a master that works in that specialty on the basis of his research. To him one must go, join in his seminar, do a doctoral dissertation under his direction.”³² My own mastery of research in the area, as I

Macmillan and Notre Dame, 1970, chapter 4, “Reasonable Betting”.

³⁰“Fanny Mae and Freddie Mac, the two government-sponsored giants of the mortgage market, were encouraged to guarantee a wider range of loans in the 1990s”(p. 81).

³¹*Ibid.*

³²*Method in Theology*, 149.

mentioned, is volume 21 of Lonergan's *Complete Works*, mainly the Central Part. What of yours? Most likely you are merely seeking a glimpse of the economic mess as it would be handled by the development of Lonergan's suggestions: we can hardly expect much more at present. A strategic identification of oneself as researcher is a way to get this show on the road, this bald rolling stone on its way to gathering *nomos*.³³

So, my first, and indeed most difficult, suggestion is, Might it not be that money is being treated as a commodity in all this mess, rather than "a system of public bookkeeping"?³⁴

Where does my suggestion come out of, and where does it go? The suggestion, a preliminary identification of a negative anomaly, goes to those competent in interpretation: in my slowly-maturing view of functional collaboration I speak out of my one village among 10,000 villages to some sub-group of a 1,000 interpreters. But note that, as a competent researcher, my suggestion carries both subtlety and weight. Like the research physicist pouring over data, there is a leap that is refinedly informed: these trackings could be the suspected Higgs particle. And it is not beyond the bounds of imagination to think that competent interpreters, say, of the 1944 - or some later year's - version of Lonergan's economics take a decent gander at the tail-end of the 1942 analysis. The relevant tail-end is section 49, "The Financial Problem", and at its conclusion the typescript ends, except for a few lines of a section 53, "Mechanism of the Cultural Expansion". So: my suggestion would go to interpreters who may still need some learning, and my suggestion comes from my puttering around as a researcher for quite a few years.

I shall return to the full cycle later, to raise questions of the psychic presence of interpreters, historians, etc as the suggestion make is way round to effective

³³"A Rolling Stone Gathers Nomos" is the title of chapter 5 of *Economics for Everyone*, a chapter dealing with the need for functional specialization in economics.

³⁴*For A New Political Economy*, 103.

communications in 10,000 village banks and stock-exchanges.³⁵ But first, let us come back to us here now.

Obviously, my suggestion goes from me to you, and you must be the judge of your existential gap. For most of my readers, I suspect, there is the discomforting challenge of heading back to the beginning of *For A New Political Economy* to seek, for a month or so, the answer to the question, What is money? If you follow through, and if my suspicion is right, than the long process of de-commoditizing money becomes part of the "vast task. It means thinking out afresh our ideas of markets, prices, international trade, investment, returns on capital. Above all, it means thinking out afresh our ideas on economic directives and controls. And if we are to do this, not on the facile model of the totalitarian or socialist regimes which simply seek to abolish the problems and with them human liberty, then there will be need not merely for sober and balanced speculation but also for all the concrete inventiveness, all the capacity for discovery and for adaptation, that we can command."³⁶ So ends the genius-work of 1942. And so much for the juggling of this or that American president, advised by the blind who will not see.

But we are thus brought back to the other more elementary research that points to beginning-flaws of present first year economics, beginning lights of future grade 12 students. There is no need to pause here over that topic: I have presented the results of

³⁵The "later" I had envisaged when I typed this was "later in this essay", but that became unrealistic. See notes 10 and 15 above. The serious consideration of the topic involves a decent grip on the heuristic 8-by-8 matrix C_{ij} {see the website book *Process: Introducing Themselves to Young (Christian) Minders*, p. 92, or page 108 of *A Brief History of Tongue*}. Effective communications is open to the full complex of possible conversations. The big problem we have in Lonergan studies is the adjustment to the contemporary need for complex metagrams, such as I list in *Prehumous 2*, "Metagrams and Metaphysics". Without that move we are trying to pack Messien into plain-chant without its staff. Again I refer you to the *Method* article mentioned in note 10 above.

³⁶*For A New Political Economy*, 105.

research into grade 12 texts and texts in economics sufficiently elsewhere,³⁷ and indeed gone on to indicate how the task of communicating a correct view might be undertaken globally at an elementary level. And I would note my view that the elementary presentation given in both the essays, Prehumous 1 and FNC 46, is the key piece of the long-term shift. It is furthermore a key piece in the effort of Lonergan students to reach a common ground: the core common ground of future democracy should surely not be too difficult for Lonergan's disciples?³⁸ So, regarding both research and communications, it is the place we should start if we are to inform ourselves and others in an elementary fashion about the foundational basis of the Lonergan invention of a science and technology of economics.

Let us now go back to that late section 49 of *For a New Political Economy* and get a sense of the fuller challenge in real and monetary terms. "When we say that the idea of money as a system of public bookkeeping has to be worked out and applied we mean above all the necessity of a money whose laws coincide with the laws of the objective process."³⁹ I might glibly note that this says it all, and indeed glibly sum that all in a single word: *Concomitance*. In preparing the index to the volume, I added an introduction which concluded with my extravagance of "bringing into focus, by entries under 'Concomitance,' the total challenge of the new political economy."⁴⁰ Are we to respect the heart-pulse of the productive machine, or are we to continue the 'absurdity'

³⁷See Prehumous 1, "Teaching High-school Economics. A Common-Quest Manifesto" and *Field Nocturnes CanTower 2*, "An Effective Strategy of Economic Reform".

³⁸In chapter one of *The Redress of Poise*, (a websitebook), "The Value of Lonergan's Economics for Lonergan Students" I made the case for the exercise as an available entry into the world of theory. This is a main crisis for the normal flow, into Lonergan studies, of interested people: one cannot replace theoretic consciousness by any brand of rich descriptiveness.

³⁹*For A New Political Economy*, 105.

⁴⁰A glance at the index of shows that the entries there under *Concomitance* are a lengthy - almost the longest - list there.

(see Index) of counterpulsing, locally and globally? But the prior challenge of the work is to come to grips with the subtleties of the ideal pulsing, so that not only economists and leaders, but also general culture, might come to say with Wordsworth, 'And now I see with eye serene, the very pulse of the machine' ('She was a phantom of delight')."

It is on that prior challenge that I would ask the community to focus, not in its complex form but in the form of the single simple grade 12 class that I have written up in 8 pages.⁴¹ And, here ye, hear ye, without meeting that prior challenge in detailed illustrations and exercises, until a firm memory is laid down,⁴² the coverage of the full sketch by Lonergan, or anyone else, will remain somewhat effete.

So I return to my earlier remarks about total coverage by myself, by Lonergan, by Anderson and McShane, and by DeNeeve.⁴³ Re-viewing these works now, I think of the parallel that I used regularly over decades between *Insight* and Joos' *Theoretical Physics*, a graduate text that was useful to me in 1956.⁴⁴ Recalling that parallel now, indeed, may well be a help to younger people tackling *Insight*. I could read **Joos** because I had worked the texts and the exercises of a range of serious undergraduate courses. Twenty pages of *Joos* represented reading and exercises in several undergraduate texts. But the same is true of *Insight*: I think of the compendious treatment of hermeneutics and its canons, treated in the same number of pages as the hermeneutics of orbits in

⁴¹They can be found in the two essays mentioned in note 37 above. To save you the hunt I can easily make them available by e-mail [my e-mail is pmcshane@shaw.ca].

⁴²On adequate **laying down** see the text quoted at note 59 below.

⁴³Eileen de Neeve's book is *Decoding the Economy. Understanding Change with Bernard Lonergan*, Thomas More Institute Papers, Sherbrooke-Valois Inc, 2008. The Anderson and McShane work is *Beyond Establishment Economics. No ThankYou, Mankiw*, Axial Publishing, 2001. *Thankyou* rhymes with *Mankiw*, the chap who became an advisor to George W.Bush. Mankiw got over a million dollars up-front his mythological treatment of introductory economics, *Principles of Economics*. See note 46 below.

⁴⁴My edition of Georg Joos, *Theoretical Physics*, is the 1951 reprint, Blackie and Son, London. I refer to it in the text as **Joos**.

Joos: both texts an impossible read without the undergraduate background, which for *Insight* just is not there.

My point is that without the slow illustrated ingestion of the dynamics of the two circuits by those serious about self-understanding, the genesis of a democratic culture will remain a remote project. I recall now asking that first group to whom I presented, in eight hours, the dense 1944 typescript in June of 1977, to look out the window at passing vehicles and have a shot at identifying what economic flow each was in. A good exercise, but only a beginning. Such an exercise could well be built into the sneaky classes that I recommended as possible in the beginning of introductory economic courses in grade 12 or first year university.⁴⁵ But, in the next generation, we have to halt this pandering to the Establishment's grip on texts.⁴⁶ Then the few subversive pointers have to become a direction in economics by, for example, following up the small bakery exercise with excursions into local micro- and meso- economics. But now I am getting too detailed regarding tasks of present strategic communications.

Still, such detailed fantasy is what is needed if we are to foster the first seeds of functional collaboration in this or in any other zone. Human studies generally are, at present, a truncated mess: it does not take rocket-science Lonergan competence to glimpse this: indeed the little bit of research that consist in reading indices of psychology and sociology to find that, regularly, there is nothing there between *pubic hair* and *rat* except, perhaps, *questionnaire*.

⁴⁵See the discussion of this in *Prehumous 1*.

⁴⁶This is a very concrete task to be mediated by future specialists in communication, their work being remotely mediated by functional research. A context for thinking forward in this revolution is the old-style research article, "After the Revolution: Paul Samuelson and the Textbook Keynesian Tradition", K.A.Pearce and K.D. Hoover, with a comment by A.Cotrell, New Perspective on Keynes [annual supplement to *History of Political Economy* (27), edited by A.F.Cortell and M.S.Lawlor, Dule University Press, 1995], 183-222. See note 37 above, for a present context: Mankiw is being used in a range of countries and translations. It is relevant to note, in this context, the massive established international disorientation of texts, with little local empirical content. A revolutionary type of text would be heavily meso-economic.

Economics, then, is just one sick piece of the global puzzle. And yet we listen daily to the catalogue of stupidities and cupidities and find ourselves asking, What is to be done? What is needed now is the turn to the subject that brings you to the question, what am I to do, and indeed brings you there luminously.⁴⁷

What is going to be done about the present financial crisis? More of the usual of course: the sort of unenlightened bureaucratic socialism that we are witnessing at the end of George Bush's reign, "the facile model of totalitarian or socialist regimes which simply seek to abolish the problem,"⁴⁸ with notable lack of success. Lonergan's raving onto paper in the 1940s is still a relevant rave, but now it has the context of his later unheard raving in the *Gregorianum* paper of 1969.⁴⁹ Let us attend, as we move into the ungrounded hope of the Obama reign, to a plea of 1943:

"Either men learn rules to guide them individually in the use of the economic machine, or else they surrender their liberty to be ruled along with the machine by a central planning board. The reality of the dilemma measures the significance of an effort, however tenuous and incomplete, to formulate the laws of an economic mechanism more remote and, in a sense, more fundamental than the pricing system. Now there is little dispute that the dilemma is real, for the liberal dream of an automatic economy has, like all dreams, at long last broken. The necessity of rational control has

⁴⁷That luminousness is difficult in a present tradition of Lonerganism, where the what-to-do question is obscured by a light-weight reading of the transcendentals. The transcendental **be intelligent** covers both what-questions, which are modally distinct."Being intelligent includes a grasp of hitherto unnoticed or unrealized possibilities"(*Method in Theology*, 53). On the modal distinction and relevant operable diagrams, see Appendix A of *Phenomenology and Logic*. The problem points to a need to return to Thomas' *Summa, prima secundae*, qq.6-17.

⁴⁸*For a New Political Economy*, 105. See note 18 above.

⁴⁹Chapter 5 of *Method in Theology*, "Functional Specialties", appeared first in *Gregorianum* 50 (1969), his rave: if you like a raverrun. Were he in his health then, and twenty years younger, he might have begun a shatteringly-innovative second volume to *Insight*, something he wrote to Eric O'Connor about in 1952: his version of Joyce's "riverrun past Eve and Adam"(the first words of *Finnegans Wake*).

ceased to be a question, and the one issue is the locus of that control. Is it to be absolutist from above downwards? Is it to be democratic from below upwards? Plainly it can be democratic only in the measure in which economic science succeeds in uttering not counsels to rulers but precepts to mankind, not specific remedies and plans to increase the power of bureaucracies, but universal laws which men themselves administrate in the personal conduct of their lives The automatism is a husk that has withered and fallen, and to cling to it is to fall into the totalitarian abyss. The old science and the old precepts have gone the way of Ptolemy and Newton. But to deny the possibility of a new science and new precepts is, I am convinced, to deny the possibility of the survival of democracy."⁵⁰

We need "an effort, however tenuous and incomplete". That effort is, providentially, the "not easy"⁵¹ effort to follow through on Lonergan's two great achievements: a theory of economics and a theory of collaboration.⁵² I have written, here and elsewhere, of the tenuous incomplete efforts we could make, a fresh pragmatism. The heart of the effort, I am convinced, is the effort to fancy, fantasize strenuously, so as to glimpse the 10,000 villages of a new global integrality, with microautonomy reigning.⁵³ It demands, of the Lonergan community, "a keenness of apprehension that is not tied down to this or that provincial routine of familiar ideas that can begin

⁵⁰*For A New Political Democracy*, 110 -11. Again, recall note 18 above.

⁵¹It is his final point about Cosmopolis in *Insight*: p. 266.

⁵² The oddity of Lonergan ism is the it focuses on what many consider his central achievement, which was only a rediscovery of interiority. To the rediscovery, of course, he added an astonishing range of updatings, but these do not seem to attract much of the school's attention.

⁵³I introduced the notion of microautonomy in *Wealth of Self*, chapter 10. It is a mighty effort of fantasy to glimpse how that micro-autonomy is to be slowly cultivated in the next million years by the Tower of Able's climbing to ever-fresher planes of meaning, and ex-planing that plane aesthetically to common sense.

anew without bitterness.”⁵⁴ Would it not be wonderful if our community could turn its attention from dead Germans to live and needy Asians, Africans and homeless ones? We have a global crisis that is not just financial, though the promise that is money is laced through every facet of our nightmare daze.

“Especially in a crisis ...the aesthetic apprehension of the group’s origin and story becomes operative.”⁵⁵ The group’s origin is, of course, the emergence of incarnate spirit seven million years or more ago, but there is the proximate origin in the unique sporting genius of Lonergan.⁵⁶ The financial crisis’s operative solution is a distant democratic global 10,000 villages that are somehow a single cell-phone internet village. It involves the global community of culture taking seriously Lonergan’s discovery of the pragmatics of collaboration and the pragmatics of economics. But the initial efforts are to be a patchwork of stumblings, and it is as well to throw in the other end of the aesthetic apprehension: a glimpse of the long road - three billion years? - to global glory. So, at the end of this essay I add, in an Appendix, my favorite image of the human quest. It is a thin image of a state of mind, until you take time to flex your molecules, to ingest its call, especially as you battle with the molecular warpings of your axial super-ego.⁵⁷ “A state of mind is an all-encompassing perception of the world that binds sensory perception, thought, feelings and memories into a seamless whole.

⁵⁴*For A New Political Economy*, 20-21.

⁵⁵*Topics in Education*, 230.

⁵⁶In recent essays I have drawn attention to the character of evolutionary sports in the realms of minding. They may be millennia ahead of their time.

⁵⁷I have been on about the superego before, in *Humus 2* and in *Field Nocturne 2*, where I quoted a letter of Lonergan to Crowe, a quotation worth repeating here. “Incidentally, re anxiety, what the Freudians call the Super-Ego is Aquinas’ cogitativa: just as the little birds know that twigs are good for building nests and the little lambs know that wolves are bad, so little human beings develop a cogitativa about good and bad; it reflects their childish understanding of what papa and mamma say is good or bad and in adult life it can cause a hell of a lot of trouble” (quoted from the 13th of 129 written communications of Lonergan to Crowe, some as short as Christmas cards, some several pages long. This letter is dated 27th December 1955.)

To produce it millions of neural brain patterns fire in concert, creating a stream of ‘mega-pattern’ The process of laying them down permanently takes up to two years. Until then they are fragile and may quite easily be wiped out⁵⁸. What eventually is to give their presence, mystery against myth,⁵⁹ a Bell-curve statistics, is the community that is strange topological region of history, solving “the problem of general history, which is the real catch”.⁶⁰

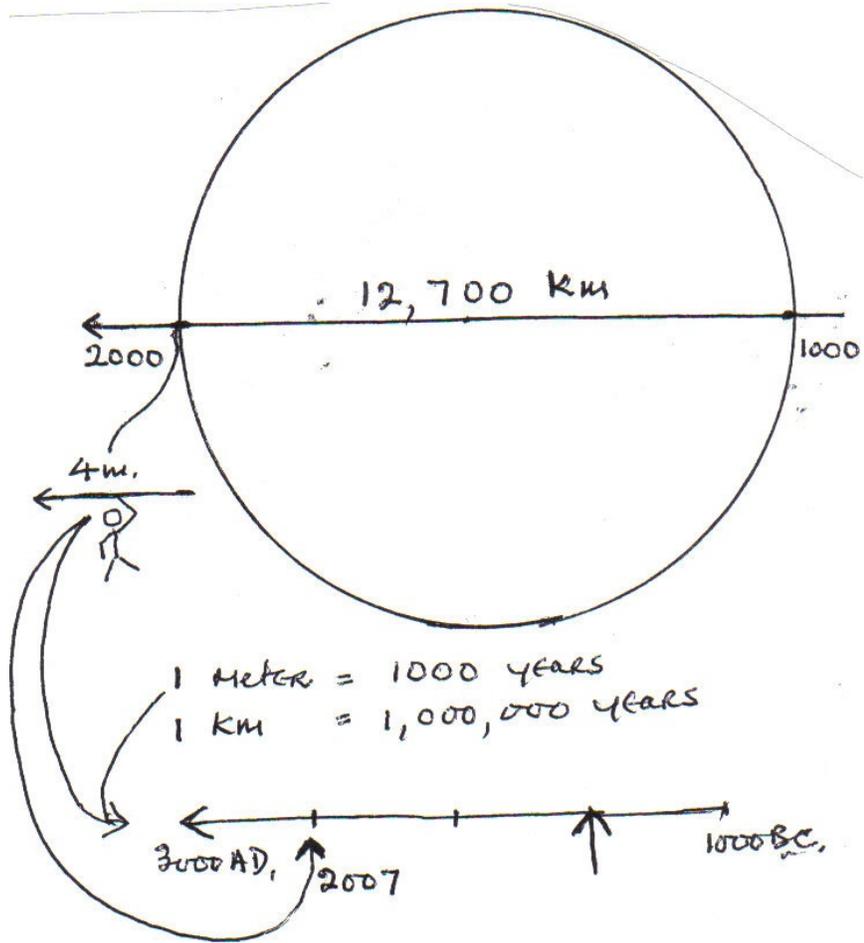
Appendix:

On the next page, a diagram to brood over. The present estimate of the age of the cosmos is 13.7 billion years. The earth is conveniently 12,700 across, so adding 1000 gives 13.7 thousand kilometers. The sun will not cook the earth for perhaps another 4 billion years: so let us think in terms of 2000 billion years of global living, not bothering at this stage to envisage galactic emigrations.

⁵⁸Rita Carter, *Mapping the Mind*, Phoenix paperback, 2002, 266, 268.

⁵⁹A context is section 1 of *Insight* chapter 17.

⁶⁰*Topics in Education*, 236. Implicit here is a hint of the solution to that problem through a peculiar regionalization of global culture. The problem of that final chapter of *Topics in Education*, on History, is treated at some length in *Field Nocturnes CanTower 50: “Insight Within a New Global Culture”*.



DIAGNOSING THE FINANCIAL CRISIS WITH BERNARD LONERGAN'S ECONOMIC IDEAS

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INTRODUCTION

This paper considers data and analyses of the current financial crisis in terms of Bernard Lonergan's explanation of the macrodynamics of finance and innovative growth. Lonergan's theory builds on the work of Hayek and Schumpeter and others of the Austrian school and is, in some ways, consistent with recent work on innovative growth by Finn Kydland, Edward Prescott, and Paul Romer.¹ Like Keynesian economists, Lonergan sees the unresolved financial hazards in growth dynamics. He discerns that the economy could move in a pure cycle of growth if people understood the process and adapted to it. Then, economies might avoid business cycle booms and busts. What is missing is an understanding of profit variation in innovative growth and willingness to adapt to it. Expansions reach a maximum and extraordinary returns to innovation return to normal. Normal profits, for Lonergan, do include a return to management as well as interest and dividends on capital investment.²

THINKING ABOUT MACRODYNAMICS

The economy is most simply understood as a circular flow of payments in production, exchange, and finance; that is (1) the outlays and incomes of people as producers, (2) their market spending for consumption and their saving for the future, and (3) the borrowing and lending of people for investment and consumption either directly or indirectly through financial institutions and government. Economists generally distinguish between producers, consumers, governments, and foreign trade in the circular flow, but the distinction between the effects of people's investment and

¹ See for example Finn Kydland & Edward Prescott, "Time to Build and Aggregate Fluctuations," *Econometrica* 50 (1982) 1345-1370; and Paul M. Romer, "Endogenous Technological Change" *Journal of Political Economy* 1990, vol.98, no.5, S71-S102.

² Bernard Lonergan, *Insight, A Study of Human Understanding*, Vol. 3, Collected Works Edition, edited by Frederick E. Crowe and Robert M. Doran (Toronto University Press, 1992 [1957]), 141-151. Lonergan describes the economy as a matrix or network of schemes of recurrence. The schemes are the interactions of production, exchange and finance.

consumption spending in the economy is less sharp.³ Consumption accounts for about three-quarters of all spending so less attention is given to investment by producers and governments.

In theory the circular flow of payments could be stationary or unchanging but, in practice, the economy is dynamic, changes over time, and in many ways has become globally connected. The payment schemes are interdependent and not always transparent. Their continuity depends on people having some understanding of the process and coordinating their economic activities accordingly.⁴

Production and exchange in the real economy of goods and services depends on the flows of money and credit for payments to and from people who are both producers and consumers. When innovations are being put in place new credit is needed to fund the new enterprise. Economists call for a neutral money supply; that is, a supply of money and credit that increases as closely as possible with growth in the real economy of goods and services. The question remains, How is the increase of money and credit for economic growth to be managed in free economies? In many countries central banks are the institutions that are given this national responsibility. And in an increasingly global economy international banking institutions and financial markets have become involved in managing money and credit.

When the increases in money and credit are excessive or insufficient, payment schemes break down. The world financial system seizes up. But the financial breakdown usually follows a peak in real economic production. The peak in the recent expansion was in late 2006 when investment in housing peaked in the U.S.A. and fell sharply in 2007.⁵ The peak is reached when the market response to a stage of innovative economic growth has reached its limit.⁶

During the first period of any major innovation (such as computers), there are extraordinary, above normal, profits for successful innovators. These extraordinary as

³Lonergan, "Division of the Productive Process," *Macroeconomic Dynamics*, 23-28; *For a New Political Economy*, _____. Lonergan highlights the functional distinction between producer and consumer goods in a way that promotes understanding of their relations over time in production. Capital and consumer goods play different roles in an economy. Producer or capital goods build the economy's capacity to produce, and are used in the production of consumer goods and services.

⁴ Lonergan, *Insight*, 233-234. Lonergan discusses the dynamism of people using their practical intelligence to develop technology, economy, and polity.

⁵ U.S. Bureau of Economic Analysis National Economic Accounts, Table 1.1.1. Accessed 23 November 2008.

⁶ The clearest example of Lonergan's macrodynamics or cycles of innovative growth is an industrial revolution. You can think of England in the 19th century, Germany at the turn of the 20th century, and the U.S. in the first half of the 20th century.

opposed to normal profits, appear in an economic expansion.⁷ When the extraordinary profits are reinvested, the advantages of the innovation can be made available to the whole economy. Moreover, the reinvestment of profits ensures that growth in the whole economy can create sufficient jobs to offset the employment and output effects of the rise in productivity. Innovation leads to a rise in productivity by producing more goods and services while using fewer resources, including human resources.

Why do the extraordinary profits in an expansion come to an end? The rewards to innovation dissipate as production approaches the limits of the market. Economists refer to diminishing returns as an economy reaches the limit of what can be produced with the land, or labour, or new ideas available in a given period.

When investment that extends innovation in producer goods reaches a limit, and profits return to normal levels, income distribution adjusts so that income differences across the population diminish. The new capital or producer goods; that is, the new plant, equipment, and newly skilled people, will be rapidly used to produce consumer goods, meeting the demand that comes with fuller employment and more equitable income shares.⁸

If the temporary nature of extraordinary profits that follows successful innovation in production is understood, income distribution will adjust. Then, the production of related consumer goods and services can be fully extended. Moreover, the larger economy's investment demand for producer or capital goods and services can prevent an absolute downturn in their output. However, when extraordinary profit from the new production of capital goods and services does not return to normal as an expansion matures, the growth in the production of consumer goods and services does not take over sufficiently to avoid a downturn. The search for high profit continues, and income distribution does not adjust sufficiently to increase consumer demand.⁹ Adding to capital and consumer goods requires different behaviours. Saving, new credit, and profits help to develop new producer or capital goods and services. Producing new consumer goods and services requires incomes that are more fully consumed.

A clear example of innovative growth comes from newly industrializing countries. We, in North America and Europe, are importing more from China, India, and Brazil. These new

⁷ Lonergan explains that the extraordinary profits of innovation are a social dividend to be reinvested so that society can share in the benefits. Like Keynes, Schumpeter and Hayek, Lonergan calls for a social level of investment. The question is, How is a social level of investment is to be encouraged in a democratic society?

⁸ Lonergan calls this second phase in innovative growth, the basic expansion. A full basic expansion depends on the return of profit levels to normal across the economy, and so a more equitable distribution of income.

⁹ Lonergan, "The Cycle of Pure Surplus Income," *For a New Political Economy; Macroeconomic Dynamics*, 144-156.

industrializers sell us cheaper manufactured goods, which benefit us. Such transfers will continue until capital infrastructure, buildings, and human capital investment is sufficient in those countries. Then their wage costs would rise, and their own people could afford to buy domestically produced consumer products. We lived through a similar process during the postwar industrialization of Japan. Eventually Japanese wages increased and it was no longer profitable for Japan to produce basic consumer goods for export.

WHAT LED TO OUR WORLD FINANCIAL CRISIS?

I turn now to our current world financial crisis. In our lives we try to foresee what is going to happen and we prepare for it or “hedge” against negative outcomes. For example, we make sure that there is enough food until the next payday, or money for school fees. Hedging is what people and corporations do in financial institutions and markets. For example, if a company has to buy or sell foreign currency when selling their products abroad, they can hedge against changes in the currency’s value by buying or selling the currency in the futures market at the currency’s expected future price now. If they are buying a currency, they are ahead if the price in the future turns out to be higher, and lose if the currency’s spot price is lower when they need it. So hedging can smooth markets over time as supply, demand, and price interact in markets like the futures markets.

Innovation in the economy includes innovation in finance. Many new hedging possibilities have been developed since the 1970s when world currency exchange rates began to vary with supply and demand in world currency markets. Before the 1970s the world financial system was the one set up by the Allies of World War II, at the 1944 Bretton Woods Conference. The U.S.A. then became the world banker by agreeing to sell gold at U.S. \$35.00 an ounce. World currency values were fixed against the U.S. dollar and gold. Since the 1970s currencies are no longer linked to gold, but vary with people’s supply and demand for them.

The role of the United States as world banker was not replaced in the 1970s, and world financial coordination depended on major world economies and the world financial institutions such as the IMF, the World Bank, and the Bank of International Settlements. It is often difficult for the global economy to balance financial flows when there are sudden changes in prices, or in supply and demand for goods and services, or changes in currencies’ exchange rates. As well, world economic decisions still depend in part on the various policies of the major national governments.

In the increasingly deregulated financial environment of economies such as the U.S.A. and the U.K. after the 1970s, financial innovation and profits could become more important than hedging in world financial markets.¹⁰ New financial instruments, such as hedge funds, benefited from the climate of deregulation in some countries. Regulators such as the U.S. Securities and Exchange Commission made their corporate regulations voluntary and did not regulate new

¹⁰ See for example, “A short history of modern finance,” and other articles on the crisis in *The Economist*, October 18, 2008.

financial instruments such as hedge funds.¹¹ Alan Greenspan, who was Chairman of the U.S. Federal Reserve or central bank from 1987 to 2006, also spoke of his faith in the unregulated global system in which “trillions of dollars of daily cross-border transaction (occur), few of which are publicly recorded.” He argued that deregulation had helped the U.S. to remain the most competitive large economy in the world, while European economic leaders recognized at their meeting in Lisbon in 2000 that their relatively regulated economies needed to become more competitive.¹²

In international finance everyone relied to some degree on the United States as the world economic leader. Between 2002 and 2007 in the United States, the supply of money and credit increased six or seven percent per year. Very low central bank borrowing rates encouraged other banks, corporations, and individuals to borrow, encouraged economic enterprise when it flagged, and financed government deficits. U.S. government policies also tended to increase people’s access to credit by writing off mortgage interest payments against taxes and by tacitly backing the national mortgage institutions, Fannie Mae and Freddie Mac. Moreover, growth in the U.S. currency has international effects. The U.S. dollar is a world currency that is held by central bankers in many other countries as a reserve currency.

Low interest rates in the U.S. permitted entrepreneurs and others (such as hopeful home owners) to borrow cheaply. When funds could be borrowed at such low rates, financiers and bankers saw the possibility of creating new financial instruments (collateralized debt instruments) which packaged the banks’ assets such as mortgages and other commercial paper. Banks could sell these debt instruments through their traders at a profit to larger banks and financial institutions around the world.

Alan Greenspan also argues in his book that, while the Federal Reserve tries to avoid bubbles that break, it is impossible to forecast or control stock markets.¹³ On the other hand the IMF’s latest World Economic Outlook argues diplomatically that “recent financial developments have fueled the continuing debate about the degree to which central banks should take asset prices (including house prices) into account in setting monetary policy . . . especially in economies with more developed mortgage markets where ‘financial accelerator’ effects have become pronounced.”¹⁴ Greenspan is criticized for failing to take the asset price bubble into account. But it is also true that the large inflow of foreign capital into the U.S. seeking a stable place to invest helped to lower interest rates there.¹⁵

In the recent boom accumulated world profits were often reinvested in U.S. government bonds, which helped to finance U.S. government deficits and U.S. deficits in the balance of payments. By 2004 low interest rates on U.S. government bonds made them a less desirable investment. Then the new U.S. mortgage-backed assets or commercial paper became attractive to

¹¹ Stephen Labaton, New York Times, October 2, 2008. Emailed by J.A. Raymaker.

¹² Alan Greenspan, *The Age of Turbulence*, (New York: Penguin Press, 2007), 367, 267-293.

¹³ *Ibid.*, 178-179; 466-467.

¹⁴ IMF World Economic Outlook, October 2008, Executive Summary xvi.

¹⁵ The Economist, “Special Report on the World Economy”, October 11, 2008, 1-35.

national and global investors. Mortgage-backed assets were developed and sold by housing developers and mortgage brokers to small regional banks, who sold them on to Fannie Mae and Freddie Mac as well as to large international investment banks in the U.S. and banks abroad.¹⁶ Everyone believed in the U.S. housing market, where prices had been rising for many years.

The role of foreign investors is another factor in the crisis. For example, the Japanese yen, also a world currency, allowed Japanese investors to borrow at very low interest rates at home to invest on Wall Street. Some economists argue that U.S. income inequality matters as well. It is mainly the lower, and lower middle income households who are defaulting on their mortgages. This is partly due to a lack of real income growth for those groups in recent years and a lack of saving.¹⁷

Traditionally, debt is taken on by banks through their risk managers. In an economic boom, when money supply and profits are rising, stock and bond traders and risk managers have quite different interests. Risk managers want to avoid risky debt, and traders and senior bankers are interested in the profits from sales of the packaged debt instruments that they hold as assets. The Keynesian economist, Hyman P. Minsky, offered a hypothesis that as an expansion peaks, investors and financial institutions become more complacent about risk.¹⁸ Investors move from hedging to speculation. In addition, during the recent boom, some economic models used to foresee economic trends were found to be calibrated on the previous four years, which were all boom years. The models did not hint that the boom would end.¹⁹

Risk managers at banks were treated as pariahs who wanted to spoil a good thing. People in financial markets and banks used borrowed funds or debt to invest in equity because interest on such debt was much lower than the profit they could make on investments. But such investment is risky. If the asset loses its value, the principal and interest on the debt used to buy it must still be repaid.

In August 2006 the first failures to meet mortgage payments began to be observed. Then, as Loneragan argued, not so much greed as “self-preservation takes over.” People tried to get rid of the mortgage-backed financial instruments they had on hand. When they found it impossible to do so, their own brokerage debt payments could not be met. The squeeze was on and the possibility of borrowing from other banks, themselves caught in the squeeze, dried up. Banks are particularly vulnerable in the downturn when falling asset values mean that their liabilities soon exceed their assets. Banks were also in trouble when they did not have the liquidity to meet short-term debt payments. As we have seen many banks have been faced with balance sheet or cash flow insolvency.

¹⁶ NPR audio “This American Life,” Summer 2008. Accessed September 2008.

¹⁷ Email from Francis Parfitt, Senior Economist, Cabinet Office – Intergovernmental Affairs, Government of Ontario, Canada, November 1, 2008.

¹⁸ Hyman Minsky (1919-1996), the Financial Instability Hypothesis, written in 1992. <http://econpapers.repec.org/paper/levwrkpap/74.htm>. Accessed November 29, 2008.

¹⁹ Frank Milne, “Anatomy of a Crisis: Role of Faulty Risk Management Systems”, C.D. Howe Institute Commentary, Toronto, Canada, October 2008.

As banks fail, not only are jobs lost in the financial sector, but the risks of other banks failing discourages interbank lending. The sources of credit dry up. Consumers too find their credit card debt unmanageable as interest rates rise and jobs are lost. New and promising projects in other industries are unable to get funding from banks or capital markets, so that their production and employment plans are delayed or dropped. Deciding when to bail out banks is crucial as banks lend to each other, which makes world banking systems closely interdependent. A stable banking system is essential to the functioning of the real economy of goods and services.

HOW WOULD LONERGAN EXPLAIN WHAT HAPPENED?

Loneragan discusses “pure surplus income” or extraordinary profit, as well as price changes over the cycle of innovative growth. It is a failure to adapt to such changes that leads to the crises and downturns of business cycles. Lonergan also comments on the “palliatives” that producers and governments have tried in the past to avoid the end of extraordinary profits. Corporations have tried excess exports, or moved production abroad where labour costs are lower, or produced armaments for wars. Labour unions have made untimely demands for wages and benefits. Some governments have had the advantage of owning a world currency which other countries pay for by exporting their real goods and services. Countries have had colonies that gave them advantages. Governments have tried the welfare state and consequent deficits as a way to handle crises. But broad welfare programs may discourage employment and may not reach those in need.²⁰ Clearly questions remain. How are people to measure the dynamics of innovative growth to understand profit variation? How are corporations and governments to ensure that extraordinary profits will be reinvested for the benefit of society as a whole as well as the corporation?

I think Lonergan would argue that profits are necessary but not sufficient to ensure a stable economy. Economists know that profit levels decrease as innovations are imitated, unless new innovations emerge. The economic players need to adapt their behaviour to a period of normal macroeconomic profit and more equitable incomes that make possible fuller employment and consumption. Such adaptive behaviour would tend to miss out on the excess profits of a boom but also avoid the debts and losses of a bust.

One way in which central banks already try to manage economic booms is to limit sources of new credit when price inflation indicates that money supply growth is excessive. Economists have also called for an economic system in which the money supply is the servant of the system of production and grows as closely as possible with the real economy. Central bankers, when they are independent of the political process do try to manage this. But central banks have not attended sufficiently to stock market or housing price bubbles, and their power is

²⁰ Lonergan, *Macroeconomic Dynamics*, 82-86. See also John Richards, *Retooling the Welfare State: What's Right, What's Wrong, What's to Be Done* (Toronto: C.D. Howe Institute 1997) Policy Study 31; “Reducing Poverty: What has Worked, and What Should Come Next,” C.D. Howe Institute *Commentary*, no. 255, October 2007

limited by global economic activities that move money in and out of national institutions. There has not yet been as much coordination among banks and governments internationally as a global economy needs.

What we must find is a capitalism that is profitable but a capitalism that understands that extraordinary profit in economic growth will return to normal levels as the production of the new goods and services stabilizes, unless new innovation occurs. Economists, most notably Keynes and Lonergan, have called for a social level of investment by the private for-profit and the non-profit sectors. In free-enterprise market economies producers and consumers are expected to act within the law and within government regulation. Regulation can be punitive and harmful to the economy, but regulation could aim to frame economic production and exchange to benefit society, not various economic interests. World leaders have now recognized that their economic interdependence demands both changes in international financial structures and better international policy coordination. These changes will take time and will call for learning, dialogue, and communication.

Lonergan's positive economics builds on the objective data experienced in recurrent economic crises. However, in a human science such as economics in which human behaviour matters, there is the question of how people foresee and respond to economic events. For example, in this financial crisis, we can expect that policy makers will not make the same errors as in the Great Depression. People can learn from their mistakes. Recently, policy makers have spoken out against protectionism in foreign trade, policies that raise taxes, and tighten money and credit, as happened earlier when countries struggled to remain on the gold standard. Such actions made the Great Depression more severe instead of helping world economies to recover.

International financial relations have continued to grow dramatically since the 1970s. But the structures of global financial institutions have changed little since 1944. New global players need better representation. The importance of Middle Eastern countries, India, China, Russia and Brazil in international trade means that the structures of international finance will require rethinking to ensure long term financial stability. Again it is decisions by people that will influence our future economic data.

Many economists have gone beyond the assumptions of economic science to raise questions about government and institutional actions in the economy. Economists such as Hayek, Keynes, Schumpeter, and Lonergan among others have also written on broader human and social themes. Certainly Lonergan insists that technology, finance, the economy, and the polity are the essential bases for human, social and cultural development.²¹ However, he places first in importance society or the people in it, for whom the economy operates. While finance is essential it is subordinate to the economy. The difficulty in a human science is that human decisions and choices depend on all these elements as well as on people's understanding of them. Economic choices are often far reaching, especially so in a globalized economy. Those making decisions

²¹ Lonergan, *For a New Political Economy*, 101; *Insight*, 558-559.

need to balance the valuable direct or intended effects of their actions against possible negative indirect or unforeseen consequences.²²

²² Kenneth Melchin, "Revisionists, Deontologists, and the Structure of Moral Understanding," *Theological Studies* 51 (1990), 389-416. Professor Melchin calls on ethicists "to understand the integral structures of linked schemes of decisions, goals, and consequences which function within concrete configurations of historical and social conditions." He argues that . . ."ethics is the sober business of rendering a service to all of humankind. Its data is the total lived experience of humankind, including its total religious experience. Its task is to understand the moral import of recurrent regularities in past experiences whose implementation in future decisions can help make life better in the widest and richest sense."