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Ethical Concerns About the Integration of European Financial Markets

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I. INTRODUCTION

Broad groups of the population (from trade unionists to conservative philosophers) seem to share the opinion that the growing integration of financial markets endangers the harmonious development of society. They often link the growing importance of international financial streams to the process of European integration. Such negative feelings build on a long popular tradition. In the literature, in the movies and the theatre, financiers and bankers very often are depicted in far from sympathetic terms. There are plenty of examples, ranging from Shakespeare's Shylock to Dickens, and from the bankers in "Mary Poppins" to Dagobert Duck. Where do these negative feelings come from?[1]

Most economists are keenly aware of the importance of financial markets for the smooth working of the economy. As they have difficulties to understand the popular worries, they tend to dismiss them as naive and old-fashioned. Undoubtedly, economists are partly right. Yet I will try to argue that a simple dismissal is somewhat too easy. A better understanding of the origin of these negative feelings may make us aware of some really important economic (or ethical) problems. Reducing the worries about financial markets to technical problems is insufficient. My argumentation remains very general and non-technical. Not all the detailed points are tightly argued and I did not aim

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at a complete list of references. The only ambition of this paper is to set up a general frame of reference[2].

The paper is structured around the different elements in its title. In fact, each of these elements may be a source of confusion. Many laymen simply distrust the working of all markets and some will even feel that markets are unethical by definition. Many economists on the contrary have an almost mythical vision of markets as the solution to all social problems. In order to make clear my own frame of reference I present in section II some general ideas about "markets". This will also allow me to introduce what I consider to be important ethical concerns. I then move on towards my topic. In section III I discuss the specificity of financial (as compared to other) markets and in section IV I introduce the idea of European integration. In section V I draw some general conclusions about the relationship between economics and ethics.

II. MARKETS

Before we can turn to our topic of financial markets, it is important first to solve some misunderstandings about markets in general. To some extent economists are responsible for these misunderstandings, because for many of them markets are "efficient" almost by definition. Partly as a reaction to this one-sided view, others (often non-economists and definitely at the other side of the ideological spectrum) see markets as embodying everything that is objectionable in capitalist societies. For them, markets stimulate egoism and leave no room for income redistribution. In my view, a discussion on the ethics of markets based on either of these two extreme positions really leads to nothing. To argue this, I want to start from an extreme and provocative example.

In an impressive book the Italian author Primo Levi (1958), who was one of the survivors of the concentration camp of Auschwitz-Birkenau, describes the daily life in the camp. In one of the chapters he gives a detailed account of the development in the camp of a (black) market for all kinds of necessities: spoons and forks, clothes, shoelaces. In principle, the prisoners had to hand over all their possessions when they arrived in the camp, but some could in one way or another smuggle some necessities with them. Despite the strict prohibition by the camp authorities, a lively system of exchanges developed. Equilibrium prices were formed and Primo Levi describes how these equilibria changed through outside influences. When workers from the town came in the camp, they sometimes were able to "import" some commodities and this supply effect had predictable consequences: an increase in the supply of spoons lowered immediately the equilibrium price for spoons on Auschwitz' black market.

I have deliberately chosen this provocative example, very far removed from my main topic, because it illustrates some basic characteristics of markets in a completely different context from the one we are used to. Let me mention four of them.

A. *The ethical evaluation of a social system has to be an evalution of the general (integrated) setting*

The example of the black market in the Auschwitz-camp is revolting and will induce a sharp feeling of moral indignation in most of us. Reading Levi's description makes us creep all over. But do we have this feeling because of the existence of the market as such? Probably not: at least my own indignation is not about the existence of the market, but about its setting within a concentration camp. This yields immediately a first important insight. To evaluate markets, one has to consider the general setting in which the market transactions take place. There is no reason why markets automatically would lead to socially desirable outcomes. Even if the concentration camp market would have been perfectly competitive (of course it was not) the general situation is far from perfect. It is no less than madness.

B. *Markets are efficient (in a certain sense)*

This being said, the market in the concentration camp was necessary to survive. Prisoners who needed better clothes to avoid freezing had to go through the exchange mechanism. Each of the exchanges was "welfare-improving" in the traditional sense: if prisoner A had two spoons, but no shoelaces and prisoner B had shoelaces but needed a spoon, it was better for both of them to exchange spoons and shoelaces. This basically reflects the general economic idea about the allocative efficiency of the market mechanism, which holds true even in the insane situation of the camp. Allocative efficiency is a relevant feature for judging a situation: within the terrible situation of Auschwitz, the existence of the black market probably improved the situation of most prisoners.

This leads immediately to a second ethical insight (and I am aware that the use of the word "ethical" in this setting is provocative- this is exactly the reason why I have chosen this example). Once markets are in place, discrimination of individuals cannot be acceptable. Since exchanges were necessary to survive, excluding some individuals from the black camp market would have been extremely unjust. In general, we could call this an aspect of "procedural" justice. Markets must be open to all interested participants. Not only must they be open to all participants: to be fair there has to be a sufficient spread of information. If a hungry newcomer in the camp "buys" a loaf of bread at an extremely disadvantageous price, because he does not know (and cannot know) the real "market price" we do not feel this to be just, even if he has agreed voluntarily to the transaction.

C. *Markets do not guarantee distributive justice*

Procedural justice is only one aspect of justice, however. From a broader point of view the camp illustrates another feature of markets: the fact that they do not necessarily lead to a just distribution. Take the case of a prisoner who did not succeed in smuggling anything inside the camp and who is too sick to "earn" something by performing services. This prisoner will have nothing to exchange: he will not be able to get anything from the market. The black market in the camp will not help him to survive. Again, this illustrates a general idea. Markets may be efficient from an allocation point of view, but there is no mechanism at work to produce a "just" distribution (however defined).

D. *Markets are unavoidable*

The most remarkable fact about the Auschwitz-market is the sheer and simple fact that it existed, despite the prohibition by the camp authorities. Even within an SS-camp and under SS-rules, market transactions took place. This points to a crucial characteristic of these transactions: two or more individuals come together and feel (they can be wrong) that they all gain through the exchange of some good(s) (including money). Therefore, the motivation to exchange will be very strong among these individuals. Moreover, they themselves are the only persons having information about their preferences. As a regulating government does not dispose of this extremely relevant information, it will face enormous difficulties when it tries to monitor these transactions.

History and actual reality indeed show that it is almost impossible to prohibit or ban markets. Control of market transactions can never be complete: think about drugs (alcohol prohibition and the maffia), weapons, illegal immigration - even kidneys. In all these cases the existence of markets may be ethically deplorable - but apparently it is impossible to control it. In this sense one could say that markets are unavoidable. In a fine paper on incentive compatability and asymmetric information, Peter Hammond (1987) talks about "markets as constraints". We may perhaps not always like market forces, but at the same time it would be extremely naive and dangerous to neglect them.

The concentration camp analogy strongly suggests that it is important to go further than a superficial debate about "markets" versus "government intervention or regulation". The simple statement that markets necessarily are "efficient" implicitly assumes a narrow definition of efficiency. It may be true that markets under some conditions may be efficient (and are unavoidable) to solve allocation problems, as in the Auschwitz-example. Yet from a broader perspective, allocative efficiency is only one among many desirable things and on its own it is certainly insufficient to guarantee a good society. In this sense, "market efficiency" always has to be complemented with other objectives. In my view the example illustrates unambiguously that the social acceptability of market outcomes is conditioned by (a) the broader social environment in which the market transactions take place and (b) the answer given to the distribution problem.

The distribution problem immediately raises the question of how to define "justice". I do not want to go into the endless debate on that question, but it seems useful to sketch its place in the overall policy discussion. At an abstract level, I think that it makes sense to distinguish two kinds of transactions in the economic sphere. First, there are transactions which lead to an increase in the welfare of all participants. We talk about exchanges and about markets. But secondly, there are also decisions which are necessarily divisive. Decisions on the allocation of property rights are of this kind- and property rights have to be defined first for market transactions to make sense. When a given amount of money is to be distributed over a given number of individuals, more money for one individual implies less money for another. This is a situation of inherent conflict of different self-interests. Violence is one option to "solve" such a conflict. Another option is for the opponents to discuss the matter in terms of rights and justice. I propose to interpret "justice" as the "word" used to structure this kind of discussions, as the concept around which the social debate can turn.

The real-life importance of that discussion cannot be overestimated. If people agree about ethical standards, these can be applied in acute conflict situations. In a certain sense, the conflict disappears, as soon as all participants agree about the way to solve it. One could say that they then agree about a social project, i.e. about the way distribution problems should be solved in a good society. As the alternative for the acceptance of such a social project is an open conflict, possibly leading to violence, the link between justice and social cohesion is clear. In my view, an open discussion about justice is necessary to avoid the fragmentation of society. Of course, this does not at all mean that there ever will be complete consensus about the concrete content of distributive justice. However, policy-makers should in any case be aware of the susceptibilities of their citizens.

While the concentration camp-analogy points our attention to the limitations of markets, it also convincingly illustrates their positive points. Allocative efficiency is extremely important. Moreover, policy interventions should be carefully considered. As said before, even the camp authorities did not have complete control over the market system in the camp. In the real world of asymmetric information, policy measures can have undesirable consequences. When working out concrete policy measures, one has to take into account the reactions of the economic agents. A strongly redistributive tax policy is not necessarily the best policy for the poor. Naive policy-making can be extremely dangerous.

III. FINANCIAL MARKETS

Let us now against this general background look at financial markets. Apparently, there is something special about these markets. It is striking how our most important philosophical and religious traditions all contain an important anti-interest and anti-money bias. The prohibition of interest (or usury) is very strong in Aristotle. Jewish thinking forbids interest payments within the community of Jews and Islamic thinking has the tradition of the prohibition of the "ribâ". Both in Jewish and Islamic communities this tradition still plays an important role. In Western Europe, scholastic catholic thinking (Thomas Aquinas) was also opposed to usury and interest. Even an economically oriented thinker like the Flemish Jesuite Lessius (around 1600 and facing the rapid growth of financial markets in the Low Countries and in Northern Italy) took in this respect a moderate position and constrained the pursuit of interest in many ways (Bouckaert (1994), contains a collection of readings on these various traditions. See also Baeck (1994)).

Of course, a modern economy could not work without interest and I certainly do not want to go back to these old traditions: we now realise all too well the economic advantages of a market economy. But nevertheless these old traditions contain some valuable ideas, which may be inspiring for our present-day attitude towards financial markets. Moreover they offer a useful starting point to better understand popular negative feelings towards financial markets. I will build up my reasoning in three steps, closely related to the general framework presented in the previous section. First, there are problems of efficiency and what I have called procedural justice. Second, there is the problem of distributive justice. Third, I would like to raise a fundamental question concerning the origin of needs and preferences and the direction of economic growth.

A. *Efficiency, procedural justice and the internal working of financial markets*

Economists emphasize that financial markets have their own specificity (see Tirole (1994), Heremans (1997)). Their role is the buying and selling of risk. They are characterised by asymmetric information: one party has superior information regarding the risk. A small saver or deposit holder cannot without considerable cost obtain information about the quality of any particular bank. A lender cannot without considerable cost obtain information about the quality of different investment projects. Moreover, the value of financial products will be highly dependent on the public's perception of and its confidence in the stability not only of the specific financial institution, but also of the financial system as a whole. These considerations lead to a need for regulation on pure efficiency grounds. Albeit to different degrees, we indeed observe such regulation everywhere in the capitalist world.

1. Systemic risk

A first argument for government intervention relates to what is called "systemic risk". If one financial institution gets into deep financial trouble, this may have a kind of domino-effect, threatening the stability of the whole financial system. This domino-effect is a straightforward example of an externality and the case for government intervention in the case of externalities is well-known. Note that one should think carefully about the best instruments for such government intervention: the previous argument does not at all imply that the government has to regulate all aspects of the everyday working of the financial system.

2. The protection of the small depositor

There is a second and more basic problem, however. In all firms in a capitalist economy the capital owners more or less control or monitor the managers. Typical for the financial sector in general and the banking sector in particular is that (a) banks finance most of their investment externally; (b) their solvency is crucial for the working of the payment system; (c) their debt is much more than in the industrial sector held by many small depositors.

Considerations (a) and (b) suggest that the need for monitoring is especially acute in the case of the banking sector. Consideration (c) suggests that monitoring by the many small holders of the debt will be extremely difficult. Many small debt-holders will not have the means or the expertise to monitor the banks. Moreover, the result of monitoring the managers is a public good for all the small depositors and an individual depositor will not be motivated to spend time and effort if he can easily benefit from the efforts of others. This is the traditional free-rider-argument. It is therefore normal to see the government entering the market as a monitoring or regulating agent on behalf of the small depositors. Economists will speak about "prudential regulation".

To a large extent this can be analysed as a pure efficiency problem. However, these aspects are also closely related to the notion of procedural justice introduced in the previous section. Is there a balance of power between the different participants in the market? Is information evenly spread over the population? One can also approach the question of prudential regulation from a different angle- emphasizing the need to protect the weaker groups in society. Unsophisticated economic agents may feel ill at ease in their contacts with sophisticated bankers and may have difficulties to understand complicated contracts. Banks (and insurance companies) clearly see this problem and attach much importance to personalised services. But this does not change the weak and dependent position of uneducated agents and their risk of being "exploited". Contrary to what economists sometimes seem to think, this situation is not necessarily improved by more competition: more competition and more choice make the decision problem still more complicated. The protection of the weaker groups in society has always been one of the basic intuitions in the traditional debate on usury and interest. It probably is also important to explain the vague negative feelings concerning financial markets in our actual societies. To many economists however this concern has a hint of paternalism.

B. *Distributive justice and financial markets*

The problems of systemic risk, of protecting the small depositors and of guaranteeing equal conditions to all participants involve (important) aspects of procedural justice specific to financial markets. However, as I emphasized in the previous section, we also have to consider the question of distributive justice. Of course, when thinking about justice it does not make sense to concentrate only on financial markets. Justice relates to the broad structure of society, to the environment in which financial transactions take place. In this sense, all the societal aspects are closely interconnected. However, to structure my discussion, I focus as much as possible on aspects of capital income, credit allocation and investment. To get a better feeling about crucial justice aspects in this context, I will derive my inspiration from empirical survey studies and from our intellectual tradition on the prohibition of usury and interest[3].

1. Capital income and the "desert" criterion

A basic idea in that tradition is the simple conviction that "money should not earn money". This same simple idea reappears over and over again in the empirical findings of social scientists on the justice opinions of ordinary people. It is part of what Elster (1992) has called the "commonsense conception of justice". A just income distribution gives (almost by definition) to all people what they are entitled to - and this entitlement is based to a large extent on "desert" or "merit" (apart from need). For most respondents, desert and merit are defined in one way or another in terms of effort (Arts and Van der Veen (1992), Törnblom (1992), Miller (1992), Schokkaert (1998)).

This general idea has immediate consequences for the evaluation of financial markets. Money accrues to capital owners simply because they own capital and very often they do not even have acquired this capital through work: being very wealthy is often a consequence of having had wealthy parents (or having been extremely lucky). This probably is the reason why many respondents (which means: citizens) feel that "capital income" is "undeserved income". This may be a vague feeling rather than a reasoned judgment and, even without considering efficiency arguments, it would be extremely naive to draw immediately the conclusion that government should ban all capital income. Efficiency arguments can only increase this need to be cautious. However, there surely is a crucial problem of justice perception by many citizens.

Let us compare this justice perception with the real world situation and thereby concentrate on the most relevant policy instrument: taxation. In most countries, the tax on capital income has become much lower than the tax on labour income. This is exactly the opposite of what most people consider to be just. The problem gets worse because citizens observe that, while it is very difficult to evade the tax on labour income, capital owners have many opportunities to evade or avoid their part of income taxes. The relevancy of this finding is obvious in a situation where the deep dissatisfaction of many citizens with the tax system presents a real challenge to politicians. This dissatisfaction can be partly explained by the simple fact that a majority of people considers the tax rates on labour income to be too high. But the growing discrepancy between the taxes on labour and on capital income is an important additional factor, which should be taken into account when one wants to restructure the fiscal system.

2. Concern for the poor

A crucial element in the Jewish, Islamic and scholastic tradition on usury is the concern for the poor. Those who are in financial difficulties and have to borrow money are in an extremely weak position. And the poorer they are, the more badly they need a loan and the stronger the power position of the lender. The possibly resulting exploitation of the poor is ethically unacceptable. Both the Jewish and the Islamic tradition are very explicit about the commandment to help the poor (albeit in the first place in the own community). This basic intuition has kept all its relevancy to understand the justice opinions of the citizens: in general they are very much in favour of introducing a minimum floor, below which no one should fall, and are sensitive to the problem of social deprivation (Elster (1992), Schokkaert (1998)).

This concern for the weakest groups in society is closely related to the procedural aspects discussed earlier. Poor people cannot easily borrow money, because they are bad risks. This implies that they often will be liquidity-constrained. On the other hand, many consumers become victim of the tendency to give consumer credit very (too) easily. A large degree of indebtedness may create huge problems, e.g., when one loses his or her job and gets unemployed. Government regulation seems to be necessary to make it possible for the poor to borrow on more interesting terms and to avoid overindebtedness of the consumers.

But it goes further than these procedural aspects. Social security, especially when targeted on the poor, is one of the most popular institutions in Western societies, albeit less popular among economists than among other citizens. The perception that the growing integration of financial markets threatens the level of social protection might therefore immediately have negative repercussions on the image of these markets. I will return to this point in the following section.

Closely related to this are the investment decisions of firms. Financial markets play an important role in directing investments towards certain activities or sectors (including the choice between real investment and financial speculation) and towards regions. Both from the point of view of long term-unemployment and structural regional poverty, these are crucial decisions. In general, it is far from obvious that free financial markets always will lead to the solutions which are to be preferred from a social point of view. Moreover, even when (dis)-investment decisions may be acceptable in a long-run perspective of growing market integration and specialisation, this is not perceived as such by the victims who lose their job. The Renault-case is a very typical example. Financial markets and private investments are therefore seen very often as contributing to the growing job insecurity in our societies. Here again, there is a real ethical challenge: how to reconcile long-term economic productivity considerations with short-term social transition problems?

C. *Needs and preferences: the fundamental debate about welfarism and democracy*

The traditional literature on interest and usury confronts us with a still more basic question. A closer look at Aristotle's approach to interest and capital suggests that he is in the first place concerned about what might be a good society (Vandevelde (1994)). He draws a distinction between production to satisfy the "real needs" of the community (the polis) and production "for money", where the only aim is to become as rich as possible without any concern for creating a good society. He rejects the second kind of activities.

The difficult questions raised by such a rejection are still very relevant now. Clearly, production for money will only be possible if one produces commodities for which other economic agents are willing to pay, i.e., which satisfy consumer preferences. But this is exactly allocative efficiency in the traditional economic sense. Where do we get if we start questioning these preferences themselves? (As we should probably do in a broader, Aristotelian, approach to justice?) Then clearly the direction of investment and production in our modern capitalist economies can be questioned. But if we question preferences of the citizens themselves, who is going to decide what are their "real needs"? I suppose nobody of us would be happy in a situation where an Aristotelian dictator decides what is good for each of us. We touch here the most difficult problems related to justice and markets in general and to justice and financial markets in particular. After having raised the question, I will now further neglect it: I have no clear answer and elaborating this point would lead to another and much longer paper.

IV. EUROPEAN FINANCIAL MARKETS

Let me summarize the general conclusions of the previous sections. Financial markets have to be regulated for reasons of systemic risk and because of the need to protect the small depositors. Moreover, from the point of view of distributive justice, private decisions concerning loans and investment have to be integrated into a social context with special attention for the poor and the unemployed. Many people have questions concerning the "just" (in the sense of "deserved") character of capital income. Let me now take the final step in this paper and discuss the process of European integration.

While European integration may have played a role in the integration of financial markets, this role should not be overrated. The mainly integration of the wholesale financial markets has been caused by a decrease in transaction costs, i.e., by the development of communication systems and information networks. European policy has been more important for the retail sector, where indeed an intensive effort has been made to remove national barriers to competition.

In many respects the opening of the markets has been positive from the point of view of market efficiency, because a larger market will lead to more intensive competition and may create opportunities to realise returns to scale. In any case, the integration of financial markets is by now largely irreversible. This again is a good example of the general idea that markets may act as constraints. Even if we would take the (debatable) starting point that it would have been ethically preferable to prevent the process of integration of financial markets, this simply is impossible in a situation with rapidly declining transaction costs. No government could monitor sufficiently all the relevant capital flows. Naive policy proposals to implement capital controls are therefore impracticable and perhaps even dangerous. This does not mean that there is no need or no room for economic policy. Indeed, the other insights of the Auschwitz-example also remain valid in this context.

A. *National regulation under pressure*

In the past, national financial markets have all been regulated to a larger or smaller extent according to the importance attached to the different considerations raised in the previous sections. In recent years, these different national regulations have come under growing pressure. There is now a lively debate among economists concerning the optimal degree of prudential regulation, the instruments to be used and the best approach for the international coordination of regulatory policies (see Van Cayseele and Heremans (1991), Heremans (1997)).

This is an important topic. But from an ethical point of view, it is the easy part. Indeed, as mentioned before, this regulation can largely be defended on efficiency grounds alone and does not require consensus about the content of distributive justice. To some extent it is even in the self-interest of the financial sector and we indeed observe that this sector tries to regulate itself. The relationships of complementarity and substitutability between this "soft regulation" (based on the desire to build up a good reputation) and government intervention is an interesting research topic. But soft regulation will not help in the face of problems of distributive justice where societies face severe conflicts of interest. I do think that most of the vague negative feelings and of the more serious ethical concerns about financial markets relate to these distributional matters.

B. *Redistribution under pressure*

International competition does not only put pressure on the internal regulation of financial markets. More importantly, it also threatens the whole social construction of Western European welfare societies. The consequences of economic integration are especially severe for the justice of financial markets.

1. Taxation of capital income

The growing discrepancy between the taxation of labour and of capital income can partly (largely?) be explained by the integration of international capital markets. Financial capital is highly mobile and goes where the tax rate is lowest. In all European countries the tax on capital income has been eroded gradually to avoid large capital outflows. Here is a real challenge. On the one hand, it is obvious that this situation hurts the justice feelings of many citizens. This may have economic consequences as it will have an influence on the bargaining behaviour of trade unions and on the willingness to pay taxes. On the other hand, the possibilities of individual countries to do something about this are extremely limited. Increasing strongly the taxation of capital income would not only be economically insane, the resulting decrease in economic activity would also have undesirable distributional consequences as the weakest groups in society would probably be hurt most severely.

Although there are no easy answers concerning the best policy reaction in this situation, there is still much truth in the conventional wisdom that the most straightforward remedy is the coordination of the tax policies of the various countries. Although still difficult (certainly as long as Switzerland is not part of the European union), it would be much easier to impose a tax on capital income at the European level. A good case can be made for such a tax both on the ground of justice and from the point of view of allocative efficiency.

2. Social protection in the EU

An analogous problem of tax competition arises with respect to the level of social protection. Where different countries compete for attracting investment (and hence, employment), there may result downward pressure on social protection. Social security and provisions for the poor are threatened. Again, the most immediate conclusion is the need for action at the European level. The construction of a social Europe is extremely important from the point of view of distributive justice (see also Atkinson (1995)). In so far as the international competition has the game-theoretic structure of a prisoner's dilemma, coordination of national policies may also be efficient, i.e., welfare-improving for all the individual countries.

Financial and investment decisions are especially important for two of the most crucial problems facing European societies today. The first is the large number of long-term unemployed. The analysis of unemployment is a complex problem, but undoubtedly investment and economic growth play a crucial role in this regard. I only want to mention here the position taken by economists like Drèze and Malinvaud (1994) (and translated in a weaker form in the Delors-White Paper) that, first, a large investment effort is needed to attack the investment problem and that, second, the present European monetary policy is too restrictive (see also De Grauwe (1998)). Clearly, both these concerns relate to the working of financial markets.

The second problem is even more difficult. It seems obvious to me that one of the most difficult challenges facing Europe is the growing pressure of labour migration from outside the European bastion. One cannot indefinitely defend an island of social security amidst an ocean of poverty. The only way to counteract these migration tendencies is the economic development of the regions around the European community: Eastern Europe, the former Soviet Union, North-Africa. If there are profitable investment opportunities, one can expect a redirection of investment streams towards these regions. In a certain sense, market efficiency and considera-tions of basic justice would then coincide. Yet the main victims, either of increased immigration or of increased investment abroad, will be the lower-skilled in Western Europe. And it is not at all obvious how the negative effects on their welfare position will be absorbed.

My overview of distributional challenges has been basically a superficial restatement of the conventional wisdom from the fiscal federalism literature that redistribution must be assigned to the highest level of government. There is now a recent, but already huge and rapidly growing literature on the consequences of economic integration for fiscal policies, in which this conventional wisdom is sometimes severely challenged. In his introduction for a special issue of "International Tax and Public Finance" on "Taxation, Redistribution and Economic Integration", Keen (1997) emphasizes that "this conventional wisdom is the start of serious analysis, not the end". I do agree. But at the same time he also notes: "Redistribution is not, it seems, a fashionable word. The topic itself, however, is likely to force itself -even more strongly, perhaps- upon policy-makers for some while yet." I could not agree more.

C. *The basic imbalance*

All this brings us to a very general conclusion. The Auschwitz-example shows that allocative efficiency is not a guarantee against madness. Markets can only function within a well-defined structure of property rights and will only yield ethically acceptable outcomes if the broader social and political environment is sufficiently well developed. This is not to say that actual international financial markets lead to insane results. But it may draw our attention to the fundamental imbalance between the development of these markets on the one hand and the development of international political and social institutions on the other hand. One can have widely divergent opinions about what is distributive justice, about the concrete macroeconomic or environmental policy to be followed, about the optimal level of prudential regulation, about the need to tax capital income. But at the same time there can be no doubt that a concrete policy in any of these domains can now only be succesfully implemented at the international level. For some of these problems, even the European level will not be sufficient. This means that we need strong international institutions. The real challenge is to design such international institutions in a democratic way. If this is not done succesfully, the perception of the unhampered working of financial markets will keep inducing in many citizens negative reactions going from a vague feeling of unease to strong ethical indignation.

V. CONCLUSION: ETHICS, ECONOMICS AND FINANCIAL MARKETS

Among many non-economists there is a growing concern about the ethical implications of the integration of financial markets. Most economists hardly understand the reasons for this concern. This situation is therefore an interesting starting point to derive some general insights about the relationship between economics and ethics.

Much unnecessary confusion arises from the mythology of markets. The provocative Auschwitz-example helps in seeing the limitations of these myths. On the one hand, markets are necessary for the efficient allocation of goods and commodities. Moreover, self-interested behaviour by economic agents will act as a constraint on the possibility of any political authority to influence economic outcomes. On the other hand, markets are not sufficient to reach acceptable ethical outcomes. The outcomes will be codetermined by the broader social and political context within which markets operate. Especially the distributional problems have to be considered seriously. An interesting discussion therefore is only possible if non-economists are aware of their blind spot for allocative efficiency and for markets as constraints and if economists are aware of their blind spot for distributional matters and broader philosophical considerations.

Financial markets are especially interesting as a test-case because they always have been looked at with suspicion by our dominant philosophical and religious traditions. This suspicion has to do with the danger of exploitation of the weaker groups in society, the doubts concerning the justice of capital income and the broader question of the relationship between investment and what constitutes a good society. The concerns about markets therefore get a very specific flavour in this context. Economists have devoted much attention to the nature of financial markets as markets of risk, characterised by asymmetric information. This is an interesting research project, leading to many crucial insights. However, such an "internal" approach is insufficient to answer the broader ethical questions about the social acceptability of market outcomes.

A closer analysis shows that the present debate turns around the imbalance between the rapid integration of financial (and other) markets on the one hand and the slow development of international political institutions on the other hand. In fact, further European integration and at the very least coordination of economic policies at the

European level is absolutely necessary. This raises a challenge which is not in the first place economic, but political. Will we be able to reach a consensus at the European level about basic justice principles? There is an urgent need for a political debate at the European level on what distributive justice really means.

Yet such a debate is really only a first step. The second necessary step is the careful analysis of the likely consequences of concrete policy proposals. Here good economics is necessary to get a realistic prediction of the effects of policy. Ethics is needed for a social evaluation of these effects. In such concrete exercises economics and ethics are complementary. This paper did not offer such a concrete analysis. In fact, it is a typical example of the kind of papers on ethics and economics of which there are already too many: a general and superficial treatment of a "big" economic problem. It is therefore good to repeat that such a general discussion can only be the start of a serious analysis, not the end.

NOTES

1. Sen (1993) also wonders at the puzzling contrast between the low image of the practice of finance on the one hand and its high social contribution on the other hand.
2. I have presented similar ideas at a COST-seminar on "Principles of Justice and the European Union" (Schokkaert (1996)).
3. Financial markets have, through interest rates and investment, a large effect on the intergenerational distribution of welfare. Future generations are not present on the markets now. Their objectives will therefore not count in actual private market investment decisions. This is especially important for environmental matters: the effects of acid rain or global warming will only appear in the near or far future. These aspects of intergenerational justice and sustainable development should be kept in mind when thinking about financial markets, but I will neglect them in this paper.

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