

THE WORTH OF RISK-TAKING AND RISK-AVOIDANCE

The Ethics of Risk Management and the Financial Industry

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Risk-management has been the catchword of the past decades in the financial industry. Financial market agents have claimed that the new risk management is able to manage risk to such an extent that financial crises will not happen again. Their risk management has not delivered. Immense losses and risks have been transferred from the financial markets to the tax-payer in the huge bailouts of banks in recent years (Koslowski 2011).

One reason for the risk-management crisis is the opaqueness surrounding the worth of risk-taking and risk-avoidance. Both are valuable but do not occur simultaneously nor under the same circumstances. When someone has developed a new technological innovation and takes financial and personal risks in order to introduce it onto the market, we acclaim his action. We would regret it if the innovation had not been introduced on account of reluctance to incur the risks. The readiness to take risks is considered to be desirable in the context of innovation.

If a person has a family with children and avoids extensive risks this is desirable for his family and for society. In the same vein, if a person in this situation were to gamble on the stock market, the risk-taking would not

be considered desirable. Under certain circumstances, caution and the will to avoid risk are considered desirable and the right conduct.

From this simple observation it can be understood that risk-taking and risk-avoidance are not the only factors of value for guiding action in the financial markets. Risk-taking and risk-avoidance are attitudes that the same individuals can adopt during different phases of their lives. A person as a bachelor may have a different attitude to risk than when he is married. A young man or woman may have a different attitude to that of an older person.

Taking a risk usually implies betting that choice of a risky alternative is better than that of a less risky alternative. The riskier alternative usually yields a higher return with a higher risk. Betting on the less risky alternative runs a lower risk and receives a lower return.

During the period that culminated in the financial crisis, the financial wager rose to a previously unknown height. The wager's rise was seen in all the financial markets. It was seen in the capital market, in which speculation on the capital gains of shares rose dramatically. It was equally seen in the credit market, in which the policy of easy money drove lending volumes to staggering heights. Meanwhile the relaxation of requirements for loan collaterals led to a higher tolerance of speculative uncertainty about debtors, and bad credit collaterals were purchased from the banks by speculative investors in the form of structured products. Finally, it was seen in the market for derivatives, in which something like an explosion of wagers on futures and options took place.¹

¹ On the scale of trading in derivative instruments, cf. Posner (2009, 144): "At its peak, the market in credit-default swaps was larger than the entire United States stock market (though that is misleading because swaps are largely offsetting)." According to Luttermann (2008): more than US\$50 trillion of credit default swaps were used to wager on synthetic derivatives and short selling.

AMERICAN CAPITALISM AND THE EUROPEAN SOCIAL MARKET ECONOMY: DIFFERENT ATTITUDES TOWARDS RISK

Behind the crisis of the financial market caused by wagers lie the tendency and deliberate aim of modern industry to push production capacity to its limits and to achieve the maximum domestic product by means of optimum capital allocation. The financial industry plays an important role in meeting this objective through its function of financial intermediation. Through its defining role in the credit market and its mediating function in the markets for capital and derivatives, it serves the optimal allocation of capital and hence the efficiency of the economy as a whole.

Investment credit creates new opportunities for economic growth. For that reason, we will continue to need the financial industry in the future. Nevertheless, the crisis shows that a failure of financial institutions is as much of a negative multiplier as their sound functioning is a positive multiplier. Financial crises, with their inefficient allocation of capital, lead to shrinkage of the real economy. It is therefore necessary to avoid any failure or malfunctioning of the financial sector. Even if the financial sector does not always achieve the production-possibility frontier in its financial services to the real economy, a slightly suboptimal allocation of capital is preferable to a full-blown financial crisis, which results from unduly risky allocation of capital by means of excessive credit provision and the total depletion of the banks' equity. If less creative and risk-laden financial instruments mean that we lose 0.5% of growth in the economy as a whole, this has to be better than a financial market crisis with substantial capital destruction and losses of growth of -5% in the national economy.

Taking the frequency of financial crises to be once every 30 years, and a loss of growth of 0.5% per year over 30 years, the calculation looks

different again. In this case, it would be better to put up with one financial crisis every 30 years. We would then be talking about rational financial crises, which would be more tolerable than foregoing the endeavor to achieve optimal capital allocation.² The choice between risk-laden capital allocation and possible financial crises is no longer so clear-cut if a substantial loss of growth over a number of years caused by less-creative financing instruments is countered by the risk of a relatively modest and infrequent crisis. The frequency of financial crises is critical.

With reference to the relationship between the efficiency of capital allocation, the efficiency of the financial industry, and growth in the real economy, it is evident that risk assessment for financial instruments is difficult, and when it comes to the question of what risks the financial system should enter into as regards its choice of instruments, consensus is well-nigh impossible. Finance ethics must therefore be hesitant about rejecting these instruments outright and declaring them ethically problematic. Even for the assessment of risky financial instruments, the fact is that ethics does not seek to counter the reality of the financial industry with an abstract principle. Rather, by considering the purpose of the finance industry and the restriction of human rights, it derives ethical normativity from its very nature. From the principle of adequacy for the purpose of an institution or the principle of the obligation arising out of its nature, the obligations derived are normative, even if they are not perhaps as comprehensive and strict as those who were harmed by a financial market crisis might hope. From the ethical principle of obligation, we can infer that we must reject merely inflated instruments which deliver no benefits for the customer or superficial solutions which reap microeconomic benefits for the financial institutions but have no macroeconomic merit.

² Thiel (1996) discusses the approaches which explain financial crises from the rationality of the actors.

According to this principle, certain forms of securitization are also ethically problematic. For instance, Posner's statement, "The opacity of complex securities to investors aside, there is nothing improper about securitizing debt—that is, transforming a debt into a security." (Posner 2009, 54), is contradictory.

By considering the purpose of the finance industry and the restriction of human rights, it derives ethical normativity from its very nature

The opacity of complex securitized financial instruments cannot be left aside. It is the central economic and ethical problem of securitization. From the viewpoint of a theory of ethical economy, it would be indefensible to create securitized instruments that are not understood and consequently cause enormous damage. It would be like allowing racing cars onto the public highway—most drivers could not handle them safely even though there would always be a few who could. The conditions for securitization must be modified and made more stringent.³ And banks must be prepared to explain the economic benefit for capital allocation of securitized bonds like collateralized debt obligations (CDOs); they are only constructed and sold in order to circumvent the banks' capitalization requirements and they thereby increase the economic or systemic risk and trigger crises.

When it comes to derivatives, the same question applies as for securitization. Do the vast majority of derivatives have any functional benefit other than to generate commissions and fees for the financial

³ This demand is also voiced by Sinn (2009, 314): "So multi-tiered securitization should be prohibited. [...] A multi-tiered securitization of often six and up to 24 tiers is absurd and fulfils no economic function whatsoever. It is nothing other than trickery to exploit the highly lax and loophole-ridden rules of the system." (Own trans. from the German).

institutions? On ethical grounds, neither inflation of the number of derivative contracts, nor its decoupling from the hedging and arbitrage function, thereby leading to economically harmful speculation, should be allowed. The objective of avoiding hyper-speculation makes it necessary for derivative contracts to be made more responsible and transparent than is the case today. through registration and the deposit of capital. As a general principle relative to financial-market speculation, it should be required on ethical grounds that speculation should not be allowed to escalate out of control and exceed the necessary level to ensure market liquidity.

The most effective way out of the crisis is to instill awareness among the actors in financial institutions and financial markets that the finance industry is not just a playground for financial geniuses and speculators. Rather, the function of banks, the stock exchange and financial advisers should be to provide service. They serve the real economy by improving the allocation of capital, which in turn is necessary for the efficiency of the economy as a whole.

Part and parcel of the service mentality of the finance industry is respect for the bank's fiduciary duty towards the customer. This duty is not only an external legal duty but also an inner, ethical duty or self-commitment. The conscious knowledge that the finance industry also has an ethical self-commitment, and not just externally justiciable duties, is a point of central importance for overcoming the financial market crisis. The financial industry must realize that it is operating in a domain of the utmost ethical sensitivity. An ethical self-commitment by financial advisers and financial institutions is indispensable for the simple reason that the state cannot underwrite every consultation with a financial adviser. The banks must understand that they are financial service providers, that their job is to serve the customer, and that they cannot with impunity sell somebody something or advise them to do something that later leaves them worse off. They have a duty to act in the customer's

interest, a duty of allegiance to the customer. The impression we are given by many financial intermediaries is that if anything goes wrong, it is a result of the general risk or market sentiment, but certainly not the result of their bad advice.

Unlike doctors, financial services providers have no malpractice insurance, but sometimes the financial advice they give is akin to malpractice. Financial service providers do not assume the role of a guarantor, as doctors do, which entails a heightened duty of care for the patient and which has stronger legal reinforcement than the warranties of other occupations. Doctors are aware, on account of their professional ethics, that if the patient feels worse after treatment, something is wrong. Financial intermediaries prefer to shift the blame onto the market, seeing it as having turned against the customer. This betrays the continuing lack of a clear code of professional ethics for financial intermediaries.

The financial crisis, like all far-reaching historic crises, has not just one but several causes. Not all are relevant in terms of business ethics—that is, conditioned by shortcomings in business and corporate ethics. Some crisis phenomena, however, were caused by a lack of ethical motivation and of willingness to act ethically on the part of financial actors, or by defective institutional ethics in the financial institutions.

The causes are not exclusively the fault of the bankers, because everybody from politicians to bank customers clamored for and capitalized on the policy of easy money and universal access to cheap credit. In this sense, everybody played a part in the expansion and overextension of the financial sector.

It is inappropriate to put the blame solely on the market economy, and on its specific components, the banks and the finance industry. The financial sector made big mistakes but the supply of unduly cheap credit

was not caused by it alone. This policy initially broadened everybody's opportunities: large investments by major corporations, house building by the wealthy and the not so wealthy and, not least, the scope for state expenditure in excess of the restrictions of a balanced budget by means of public borrowing on the financial market.

It was a social policy desideratum that even poorer people should be in a position to borrow in excess of their normal creditworthiness to buy their own homes. Cheaper home mortgage financing, particularly in the United States, was not invented by bankers but by politicians. It is also wrong to say that simplifying access to mortgages is bad *per se*. On the contrary, this reduction in the cost of mortgages was an element of the demands of the 19th century social reform, realized by the introduction of cooperative and mutual banks.

The policy of cheap money also helped the financing of Germany's extraordinary burdens, like German unification and America's extraordinary burdens, like the Iraq war. Nobody wanted to impose consumer austerity on the German or the American populations to cover the bloating of these items of public expenditure, as would have been necessary in order to finance them entirely from taxation. Politicians chose credit financing and public borrowing, which contributed to the overstrain of the credit market. Public borrowing in Germany followed a dramatic trajectory, growing almost fourfold in the decade after German unification.⁴ Such a steep rate of increase was bound to trigger an explosion in the financial sector.

Therefore the scale of the current crisis cannot be blamed solely on the greed of actors in the financial institutions. It was also a consequence of the fiscal and welfare state, which has had to meet more and more

⁴ Source: Bund der Steuerzahler (German Taxpayers Association), according to Statistisches Bundesamt (Federal Statistical Office) (1950–2007) and own calculations by Bund der Steuerzahler (2008–2009).

commitments. Likewise—not least on account of international competition from tax havens—it cannot crank the tax lever any tighter and therefore has to resort to public borrowing and call upon the market for credit.

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After the collapse of major banks with illustrious histories, the word on everyone's lips is more control. Nevertheless, it is necessary to steer a course between the extremes of fully- deregulated capitalism, on the one hand, and state control of the financial sector, on the other, along a third route of ethical self-commitment and self-control within the framework of a market system based on the model of the social market economy.

In the decade of 1997 to 2007, voluntary restraint and self-control in the financial sector were ideas that were out of sight and out of mind, replaced by the idea of the efficient market, with external competition which rendered voluntary restraint by market participants superfluous. Control by means of efficient markets was also the basis of the Washington Consensus which was deemed to apply to all countries and to the global financial market. In contrast to the Washington Consensus, the consensus of the theory of the originally German Social Market Economy, which was introduced into the “constitution” of the EU by the Lisbon Treaty,⁵ rejects

⁵ Article 3, 1 of the Consolidated Treaty on European Union (TEU) of 1 December 2009 states: “The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It shall promote scientific and technological advance.” Online: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:115:0013:0045:EN:PDF>.

any such dogma of market infallibility and holds it to be permanently beyond the pale of rational discussion.

The Social Market Economy does not defend the thesis that markets infallibly produce correct information, but rather that they produce the best possible information while sometimes functioning inadequately or imperfectly. The Social Market Economy is cognizant of the limits of human rationality. In “social market economy,” the attribute “social” should not therefore be understood to mean “redistributing,” “equalizing” or “leveling,” but rather, “having an attenuating influence on instabilities.”⁶

The effects of the limitations of human rationality in the market, coupled with inordinate selfishness, cause instabilities, as the financial crisis shows. Attenuation of these instabilities is the goal of the social market economy. In taking cognizance that market instabilities will need to be attenuated time after time, the Social Market Economy is intellectually ahead of the harmony-credulity of shareholder-value capitalism, and is therefore superior in terms of the theory and practice of the market economy. Risks are, however, not only inherent in the Anglo-American system. They are also inherent in the continental European systems, even if one system is sometimes the mirror-reflection of the other. Anglo-American capitalism is threatened by the crisis of pensions due to the

⁶ Hauser (2006). In his talk at the same conference, the author of this paper saw the future of Germany’s Social Market Economy in a rather dismal light, in that the word “social” in “Social Market Economy” is increasingly shifting away from the sense of “attenuating instabilities” towards “redistributing” and “corporatist bargaining between major parties and associations,” a mood exacerbated by Germany’s demographic and pension problems. As an impact of the crisis in the financial market, the pension problems of American “pension fund capitalism,” far from diminishing, have been rendered rather greater today by the financial crisis than the woes of Germany’s pay-as-you-go pension insurance scheme; although this is no more than cold comfort for the threatened German pension system. The financial market crisis will force the Social Market Economy to revert to the original meaning of “social” as “attenuating instabilities,” thereby restoring its vitality and appeal. Cf. on the theory of the Social Market Economy, Koslowski (1998).

weakness of the capital market; the European Social Market Economy's pension system is endangered by the demographic problem.

Another aspect of the theory of the Social Market Economy is the awareness that market instabilities are related to the problems people have in accurately gauging risk. People can take excessive risks in the market. Therefore the Social Market Economy attaches great value to strict adherence to the banks' capitalization requirements, which have been undermined since 1980.

The Social Market Economy is equally cognizant that people in the market may be too risk-averse and do not take big enough risks, which is not a good thing either. So it is no good invoking the "social" attribute to reinforce demands for the German finance industry to adopt an unduly risk-averse strategy as opposed to the high risk strategy of the Anglo-American finance industry, because this would not be social at all: such a strategy of the financial system would waste considerable macroeconomic growth potential from which the economy as a whole would no longer stand to benefit.⁷ The rise in the cost of finance in

⁷ The same applies *mutatis mutandis* to regulation. If this produces higher costs than returns, it must also be hauled onto the dissection bench of criticism, according to Siebert (2008, 11). Lepore (2009, 34–41) points out in her essay on the history of the treatment of debtors and bankruptcy in the United States that the United States has a different, more forgiving and therefore more risk-embracing relationship to debt and bankruptcy than Europe: "Americans, though, came to prefer forgiving everyone's debts, on the ground that sorting debtors into two systems (bankruptcy for wheelers and dealers, debtor's prison for chumps) is, finally, undemocratic. Americans fought to provide the same debt relief for everyone because we believe in equality, and because bankruptcy protection makes taking risks less risky. Americans, Tocqueville wrote, 'make a virtue of commercial temerity'. We like risk. 'Hence arises the strange indulgence which is shown to bankrupts.' Our willingness to forgive—and forget—debt lies behind a good part of our prosperity [...]. Some Americans want traders to pay the risks we all took, as if traders *sinned* but we were merely *investing*." Since the settlers in 18th century America were deeply in debt to traders in London, Lepore takes the view of the American Declaration of Independence as a fortunate reprieve: "Virginia planters like Jefferson and Washington were monstrously in debt to merchants in London [...]. Declaring independence was a way of cancelling those debts. The American Revolution, some historians have argued, was itself a form of debt relief." (ibid., 36).

Germany would cost potential economic growth and would leave Germany and other continental European countries to fall behind other states of the international community of states.

One great difference between the United States and Europe resides in mentality: Americans who started as emigrants from Europe are risk-takers; Europeans who stayed in Europe are risk-avoiders. An even greater difference between the United States and Germany resides in the greater realism as well as a certain caution found in the model of the Social Market Economy, which draws partly on experiences of severe crises in the German economic system in 1923, 1929, and 1945 to arrive at a more realistic assessment of the market economy than the historic victors' perspective of American capitalism. The market economy is the best of all conceivable economic systems, but it is not infallible. Cognizant of the fallibility of humans and human institutions, it needs its regulatory framework. Germany in particular—in the light of its history, the atrocities of the regression to Nazism, two World Wars and two additional stock market crashes—and continental Europe in general are more pessimistic and cautious than the United States and the United Kingdom.

In the 1920s, there was only one crash that hit all the Western countries, and that was the stock market crash of 1929, whereas Germany alone was affected by the earlier currency wipe-out and stock market collapse of 1923, which occurred largely as a consequence of the Treaty of Versailles war reparations;⁸ the German currency fell to 400 billion (!) *Reichsmark* to the dollar, and Germany alone saw its currency collapse once again after the Second World War. Therefore people in Germany are understandably more alarmed by the current crisis, and they place more

⁸ Not forgetting that these, in part, were also a reaction to the—albeit substantially lower—French reparation payments following the Franco-Prussian war of 1870–1871.

value on monetary stability—including during the present phase of crisis management—than those in charge of American monetary policy.

Especially compared to the currency collapse of 1923, we can afford to view the present financial crisis of 2007–2008 with greater equanimity. In comparison with the dimensions of Germany's historical financial crisis, the present one is considerably more modest in caliber.

The Social Market Economy considers the minimum equity requirement upon financial institutions not just from the perspective of the banks but of the financial system as a whole. In the past, this has often been at odds with the interests of Germany's *Mittelstand*, its small and medium-sized businesses, since they like to borrow as cheaply as possible. Sure enough, by June 2009 the German spokesmen for business owners were calling for a new kick-start to the securitized bond market in order to lower the costs of their corporate borrowing. All the criticism of securitized loans, especially CDOs, was making credit more expensive for businesses, they claimed.⁹

A risk assessment will have to be conducted in such a way as to strike an appropriate balance between the corporate interest in cheap finance and the public interest in the stability of the financial sector through the sufficient capitalization of banks. This appeal for easy money, even in the very midst of the crisis, shows how difficult financial discipline and the right degree of the financial system's risk-taking are to define and maintain.

⁹ "Der Staat soll den Verbriefungsmarkt ankurbeln. Sorge vor Kreditklemme im Mittelstand/ Banken brauchen Instrumente zum Risikotransfer" [The state should kick-start the securitization market/ Fears of a credit crunch in small and medium-sized businesses/ Banks need instruments of risk transfer], *Frankfurter Allgemeine Zeitung*, 18 June 2009, 138: 22.

RISK-TAKERS AND RISK-AVOIDERS IN THE POPULATION AND THEIR RESPECTIVE RIGHTS

Is there unnecessary speculation and risk-taking in the derivatives market? Speculation is essentially a wager on future price changes. Speculation in derivatives is a wager to the power of two. Not only is it a wager on the future, on future values of a given factor; it is also a wager about the effect that a nominated value of that factor will have on the future value of another factor at a nominated future point in time. It is evident that the winnings from the wager, if the wager were successful, would be higher for the derivative wager than for the simple wager on the future value of shares or commodities. The prerequisite for a wager is to find someone who will place a counter-wager. Somebody who wants the protection of an interest-rate swap because he expects future interest-rate rises must find another party for the swap who will place the counter-wager that interest rates will fall. Since both parties have opposite but complementary future expectations, nothing stands in the way of their wager. In the case of derivatives, unlike other wagers, part of the stake is paid as a fee.

Anyone can use a wager to hedge against anything with anyone, if they both have opposing but complementary expectations about the future. The case is theoretically possible that half of the entire gross national income is staked by one half of the population on A_x , where $x=1\dots n$, and by the other half of the population on $\text{not-}A_x$, $x=1\dots n$. The macroeconomic value-added effect of this total wager is, however, zero because in the macroeconomic perspective, this is a zero sum game. Half of the population gains what the other half loses. Moreover, since wagering costs must also be reckoned—i.e. the commissions and fees charged in the financial markets—the total benefit gained, despite the income generated in wagering fees, is actually negative because productive activities are suppressed.

The example is, of course, fictitious because no economy can be preoccupied with wagering to the exclusion of all other activities. The question that arises, however, is what scale of wagering an economy can really afford, even if wagering is useful for hedging against price fluctuations? In a free economy, nobody is in a position to stipulate what share of gross national income this should be. But it is the task of financial market actors to ask the question. Is the derivatives market a place of real value-creation for hedging purposes, or just a vast betting shop? What about the opportunity costs of derivatives speculation? Could time and intellectual effort have been deployed more productively than in speculation?

The market for derivatives has positively exploded in the last decade. The statistics on derivatives are evidence of the scale of these wagers:

According to an estimate, the volumes of derivatives contracts in the world amount to US\$1.6 trillion (= 1,600 million million or 1.6 million billion) (Bogs 2007, 9).

In 2004, the world's largest economy, the United States, recorded gross national income (GNI) of US\$12,969.56 billion; Germany's GNI for 2005 was US\$2,852.33 billion (source: World Bank, by the Atlas method). If we projected this volume of derivatives onto the United States alone, it would mean total wagers of US\$123.36 billion for every billion dollars of American GNI and a wager of US\$123 on every dollar of income. If we assume a notional average American income of US\$24,000 per year, then wagers amounting to US\$2,952,000 would be riding on the average annual income of every American. Luttermann (2008, 20) estimates that derivatives to the value of US\$600 billion exist in the global market. According to the considerably more conservative estimates of the International Swaps and Derivatives Association (ISDA), the total volume of issued derivatives contracts in 2007 rose from US\$327.4 to

US\$454.5 trillion.¹⁰ Interest-rate derivatives, such as interest-rate swaps, accounted for by far the largest volume of contracts. According to the ISDA, the volume of issued interest-rate derivatives rose in 2007 from US\$285.7 to US\$382.3 trillion.

If the ISDA-estimated volume is projected by the same procedure as the first higher estimate, there are still wagers amounting to approx. US\$838,552 riding on the average annual income of every American. Of course, these wagers are not placed in the United States alone. Projection onto the world population is difficult. Nevertheless, the volumes of derivative wagers are staggering, and so are the volumes of wagering costs. It is also evident that the wagering volume in derivatives far exceeds the volume of derivatives necessary to meet hedging needs, and it serves the purpose of sheer speculation.

There is a strong suspicion that banks are entering into too many wagers in the form of options or structured products. One wager may be rational to hedge a certain risk, but hundreds of wagers to hedge the same risk are not. A thousand-fold wager on the same event is not an effective means of hedging. The only need it meets is the desire of market players to place wagers. Wagering on this scale is comparable to tax-planning. When individuals in a fiscal state devote more time to tax-avoidance than to productive activities, there is a problem: What is rational for an individual's private economy is not rational for the economy as a whole. As in the case of derivatives wagers the amount of energy and effort used for tax-avoidance would be better deployed to productive uses.

Financial wagers differ from games of chance only when they demonstrably provide some economic functionality, or a contribution to

¹⁰ "Finanzmärkte: Derivatemarkt wächst stark," *FAZNET*, 16 April 2008, <http://www.faz.net/s/RubF3CE08B362D244869BE7984590CB6AC1/Doc~E01C5CE6CC87149F8BE61DF204CD07505~ATpl~Ecommon~Scontent.html>.

value-creation such as hedging, market liquidity, or arbitrage. But even if such functionality is present, that in itself is not sufficient to determine what volume of financial wagers is useful and value-creating. Even if financial wagers are demonstrably useful for the financial markets, more wagers may be placed than are necessary for this purpose, and the excess of wagers may not only be non-functional and inappropriate for the purpose, but may even be detrimental. The extension of financial wagers to a dysfunctional scale encourages financial wagers of the gambling type and shifts the financial markets for these wagers in the direction of a space for games of chance. Excessive financial wagers create excessive liquidity in the markets, which only serves the gambling motive and increases price fluctuations.

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The rule for options is therefore: if options are to fulfill their function for hedging and arbitrage, for the fulfillment of these functions a certain extent of speculation is necessary to ensure the liquidity of the market for options. If this speculation in options significantly exceeds the amount necessary for this purpose, the element of gambling in speculation in derivatives may gain the upper hand. This danger exists when there is no obligation to register options and no cash deposit requirement.

Essentially, in the market for derivatives, a wager or an option contract can be arranged about anything and guaranteed by the option writer. As with other wagers, the extent of wagering activity and the stability of the market for derivatives in relation to the economic function of derivatives plays the decisive role. If non-value-creating wagers suppress other value-creating economic activities, an economic problem exists even

where wagering causes no direct harm. The problem caused by excessive wagering activity is the opportunity cost of such activity: other, value-adding activities could have taken its place. The non-value-adding activity of derivatives wagering suppresses other, value-adding economic activities.

Some have to speculate and take risks as a pre-requisite so that others can merely calculate and invest as well as avoid risk. Both professional speculation, as well as the amateur speculation that rose dramatically in the run-up to the financial market crisis, enable others, who prefer not to speculate, to limit their risks by 'hedging'. When speculation is taken to excess, there is a portion of speculation which no longer serves non-speculative purposes, such as hedging and the liquidity of financial markets, but which consists of self-dealing. The principle that "Everything worth doing is worth doing in excess" cannot and must not govern financial speculation.

This judgment is unduly cautious. When wagers amounting to many times gross national income are placed in the form of derivatives, the constructive and functional element of derivatives speculation is in danger of being forgotten, and the line to chance-based gambling in danger of being crossed. Although this does not turn derivatives into weapons of mass destruction, as Warren Buffett claimed (Berkshire Hathaway Inc. 2002, 13 and 15),¹¹ because no harm is intended, nevertheless they are financial wagers which have, for the most part, crossed the line into chance-based wagers and which therefore cause macroeconomic harm on account of their opportunity costs.

How was it possible for so many derivatives wagers to be placed for such high amounts? For the investor, the highly leveraged nature of derivatives

¹¹ "We view them [derivatives] as time bombs." "In our view, however, derivatives are financial weapons of mass destruction, carrying dangers that, while now latent, are potentially lethal."

trading makes it easy to enter the derivatives market but difficult to exit it when the high option-wagers do not work out. To quote Buffett (*ibid.*, 15), options are like hell: “easy to enter and almost impossible to exit.” In a certain sense, that applies to all wagers.

DEBT AND GUILT, BANKRUPTCY AND HELL

Hell is the imagination of the complete and irreversible failure of human existence. Its equivalent in business is bankruptcy. In religion and in business, hell and bankruptcy must be avoided. Culpability, debt and forgiveness are pivotal concepts of Christianity. According to Margaret Atwood, “The whole Theology of Christianity rests on the notion of spiritual debts and what must be done to repay them, and how you get out of paying by having someone else pay instead.¹²” A passage found in the writings of Augustine of Hippo (*Confessiones* V, 9, 17) declares that God not only grants remission of debts but makes himself the debtor. Nietzsche takes up this idea: in Christianity, the creditor sacrifices himself for the debtor, “God sacrificing himself for man’s debt, none other than God paying himself back, God as the only one able to redeem man from what, to man himself, has become irredeemable, the creditor sacrificing himself for his debtor, out of love (would you credit it?), out of *love* for his debtor! ...” (*Genealogie der Moral*, 2. Abhandlung, § 21, KSA 5, 331).¹³ Phenomena like the economic relief of debt, the remission of payments to a later date and debt relief rituals, according to Waldenfels, are the

¹² Quoted after Paumgarten (2009, 49). Paumgarten refers to Atwood (2008). The author has shown this connection between obligations and debt relief with reference to the “satisfaction theory of redemption,” a theory of the assumption of debt by a third party for the satisfaction of the creditor. Cf. Koslowski (2005, 421–436), Koslowski and Hermanni (2009), and Koslowski (2010). Paumgarten (*ibid.*, 57) concludes his article with the statement: “Capitalism without bankruptcy is like Christianity without Hell.”

¹³ Saint Augustine and Nietzsche cited after Waldenfels (2005, 301); quotation from Nietzsche’s second essay (Nietzsche, 1994–2007, 63).

“extraordinary fringe” that surrounds normality (Nietzsche 1994–2007, 303). In this sense, the European Financial Stability Facility (EFSF) established for stabilizing the Euro is the extraordinary fringe that surrounds an otherwise normal currency.¹⁴

Hell and bankruptcy share the feature that we hope they will not happen but cannot be sure about it. We wish the market economy were an order without bankruptcy and Christianity a religion with a hell that is empty. Some theologians claim that hell exists but that no one is in it. Certainly, there are no economists who would deny that bankruptcy exists and claim that no one is in it. Again, hell and bankruptcy have the function to signal to the individual that it is wise to reflect on risk and to be neither too risk-taking nor too risk-avoiding since the failure to do so can result in irreversible loss.

¹⁴ The European Financial Stability Facility (EFSF) was created by the Euro area member states following the decisions taken 9 May 2010 within the framework of the Ecofin Council.

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>> Risk is not a homogeneous phenomenon. Sometimes, risk-taking is considered to be positive, as is sometimes risk-avoidance. This paper investigates the conditions under which risk-taking and risk-avoidance are considered to be positive. It compares the differences in attitude towards risk in American finance capitalism and the Continental European Social Market Economy. It examines the rights of risk-takers and those of risk-avoiders in the population, in which both must be taken into consideration. Risk-takers should not transfer the burden for their financial speculation onto those parts of the population that are risk-averse and disapprove of it. In this perspective, the bail-out of financial institutions by tax-payers is problematic.

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