ELSEVIER
Journal of Banking & Finance 26 (2002) 1697–1718
Journal of BANKING & FINANCE
www.elsevier.com/locate/econbase

Introduction

Managing ethical risk: How investing in ethics adds value

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Abstract

In September 1999, the University of Notre Dame hosted a conference entitled "Measuring and Managing Ethical Risk: How Investing in Ethics Adds Value". The motivations for hosting the conference and the papers presented there are summarized. Several themes that are present in the papers are discussed. These include the gains from combining the anthropological approach to business ethics with the neoclassical economics approach, the central role of trust in business ethics, the role of ethics in the corporation, and the function of the legal system in setting and enforcing ethical standards for the financial system.

JEL classification: A12; A13; D6; M14
Keywords: Ethics; Trust; Legal system

1. Introduction

In September 1999, the College of Business at the University of Notre Dame held a conference entitled "Measuring and Managing Ethical Risk: How Investing in Ethics Adds Value". This conference brought together experts in Economics, Finance, Law, and Philosophy to discuss the role of ethics in economics and finance.

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PII: S0378-4266(02)00188-7

One of our motivations for hosting a conference on this particular subject at this particular time was the East Asian crisis of 1997–1998 and the halting progress toward economic development in the nations of the former Soviet Union. Over the last decade, societies in eastern Europe and Asia have been using various approaches to change their government dominated economic systems to ones based on markets. In making these transitions, these societies have received substantial advice from both academics (including several of the conference organizers) and international organizations. This advice tends to focus on the development of private property rights and the various institutions that support these rights such as bankruptcy laws and courts. [1] While such property rights are necessary for a market economy, Arrow emphasizes in the quote below that there is an intimate connection among the price system, property rights and ethical behavior.

"More basic yet, I will say, is the idea that the price system, in order to work at all, must involve the concept of property (even in the socialistic state there is public property). Property systems are in general not completely self-enforcing. They depend for their definition upon a constellation of legal procedures, both civil and criminal. The course of the law itself cannot be regarded as subject to the price system. The judges and the police may indeed be paid, but the system itself would disappear if on each occasion they were to sell their services and decisions. Thus the definition of property rights based on the price system depends precisely on the lack of universality of private property and the price system. This ties in with the third hypothesis put forward in Section 1. [2] The price system is not, and perhaps in some basic sense cannot be, universal. To the extent that is it is incomplete, it must be supplemented by an implicit or explicit social contract. Thus one might loosely say that the categorical imperative and the price system are essential complements" Arrow (1972, p. 357).

One of the ethical complements to the price system that Arrow explicitly recognized is trust. This includes trust between individuals in the society as well as trust in the fundamental institutions in the economy. Starting with basic interactions between individuals, any transaction involves a promise to deliver a particular good in good condition in exchange for a promised payment either in terms of money or other goods. In this transaction, the individual trusts that the good will be delivered, that the individual's property rights will be protected in a fair and honest proceeding by the courts, that the government's tax laws will be enforced in a fair and uniform manner, and that the value of the money will be protected by the central bank. This trust is often taken for granted in a well functioning economy, but recent economic history has made painfully clear how important trust is by demonstrating what happens when it is missing from the society. [3] If any part of this transaction is subject to

[1] See Stiglitz's (1999) address to the World Bank conference on development economics for a general discussion of these issues. Stiglitz also quotes part of the statement by Arrow (1972).

[2] This third condition is "... an implicit social contract such that each performs duties for the other in a way calculated to enhance the satisfaction of all".

[3] An obvious example is the VEFA Ponzi scheme in Albania during the early nineties. See Associated Press (1997).