New ways of sharing risk
Chapter 15 in Responsibility and its Avoidance.
[Curtis 2017 pages 214-224 Matador]

15. New Ways of Sharing Risk might have Averted a Recession

The modernist thrust towards individualism in governance led, sometime in the 1990s, to a focus upon risk. Bureaucrats were obliged to prepare risk assessments alongside their project proposals. Then along came the banking crisis to give the exercise some realism. Giving and sharing are age-old responses to risk in all societies – though somewhat neglected in modernist ideology. Perhaps these principles have to be discovered anew. My thoughts are prompted by memories of a conversation in the Sudan.

Sometime around the year 2008 the world moved from banking crisis to economic recession. Governments around the world – led by Gordon Brown he would have us believe - waved their magic wands to conger up the billions of dollars to fix it. But clearly what we see is systems failure. As an anthropologist any understanding that I can bring to this issue is about institutions, how they work or do not work and what happens when they fail. The many sets of economic and fiscal institutions which provide incentives and constraints to the innumerable economic actors worldwide are no longer performing as expected. National governments and international agencies have had to behave in ways that they normally avoid. The ebb and flow of normal transactions had declined to a trickle; anxiety had taken hold. To get things going again, rules would have to change, but where to look for precepts? Most institutional change entails tinkering at the margins but sometimes something more radical may be required. This note focuses upon risk and trust. The ways in which risks are perceived and distributed is central to understandings of human institutions. My anthropology [and a bit of game theory] tells me that giving and sharing generates relationships of trust that are at the heart of institutionalised exchange. According to a well-placed informant, risk sharing is recognised as an underlying principle of Islamic banking. Might this be a source of wisdom in institutional reconstruction?

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In the practical world all institutional arrangements seem to be accommodations over time to the interests of a variety of stakeholders, more powerful stakeholders having the greatest influence over shape and form but the less powerful only being prepared to 'play ball' if there is something in it for them. Institutions – sets of rules - take on a sanctity that stems simply from the fact that they apparently 'work' for many or perhaps even most people, most of the time. 'Path dependency', as economists have it, is a sanctification of workability.

Is then workability all? Has ethic or principle no place in the establishment of financial institutions? Ethical investments funds can help people exercise a bit of choice as to where their savings go but such institutions do not challenge the basic workings of the sector. Ordinary citizens, egged on by the press, can protest about the corporate greed, bloated bonuses, golden handshakes, or even the scapegoating of failure. But such protest does not question principle either. For the most part Joe Public is persuaded that the ethic of money is the law of economics.

Where might a challenge come from? It might come from party ideologies but the dominant UK political parties seem loath to invest much political capital in spelling out principle. Interestingly, with the exception of Islam [of which more below], present day religious leaders also go light on appeal to the higher principles; charity, equity … embodied in the teachings of their faith, as interpreted through the ages, in which accommodation to human imperfections is held in tension with the higher values. This gives another twist to 'what works'. So when a system fails to work should we not be open to ideas from many sources?

The answer to the riddle is an egg, apparently, though the Opies admit uncertainty as to how a listener would assume that an egg is naturally located atop a wall. I would like to be contentious. This ditty is far too good an expression of populist delight in the downfall of the 'high and mighty' to be simply a mind-teaser. It is an expression of deep buried social DNA. Brain scientists call it schadenfreude. Think; peasant tenant on hearing that the Abbot has choked on a fish-bone; serf militiaman seeing his king fall off a horse; or to bring it home to the 21st Century; 'Big Banker Falls from Grace'. Leave it there for a moment: I will return to support the idea that the rhyme is social commentary that emerged at some time when speaking truth about power was a hazardous business, best achieved in anonymity. But back to the language problem.

The test for any system comes in times of crisis, when the established interests of some or perhaps many people are no longer satisfied by the outcomes of current sets of rules. High principle is not necessarily challenged but the imperfect accommodations that we live by are thrown into question. Then the apparent human need to allocate blame may cloud perceptions of what is either good or effective. The present is such a time. There is an undoubted banking crisis underway and worldwide recession is real – although recovery is spottily taking place. What has worked is no longer working, but why?

Cultural Theory – the variant of Anthropology that has something to say here - is not encouraging. [1] The normal response to system failure – according to this theory - is to reinforce the system and to allocate blame for failure externally; usually implicating the poor [such as sub-prime mortgage holders] or the lowly [such as front line touters of loans] or the deviant [the lone rogue trader]. So, as a curious commentator, I may get caught up in the blame process. Management Theory is however more optimistic; 'A time of crisis is a time of opportunity'; so here goes.

A crisis can be read as risk gone wrong. Normal actions within apparently normal rule constraints have had abnormal effects. So to fix a system that is having unexpected outcomes we need to look at the way in which people seek to handle risk. Let us posit three contrasting approaches. The hierarchical response to risk is to build in centrally controlled routines and monitoring regimes whereby people 'up the pile' can be assured that people 'down the pile' behave according to established practice. The hosts of regulators in the money business are there to enforce this ethic. Group approaches by contrast arise where a group of individuals [or legal person entities] face a common risk. Mutual agreement backed up by mutual monitoring is then the game, leading to institutions that we tend to call mutuals [such as building societies] or to mutual risk sharing arrangements such as banking federations. Moderation of an individual banker's behaviour through professional associations is another means of mutual regulation. Lone individuals – anthropologists find - exposed to the full rigours of what life can throw at them, create reciprocal obligations through gift exchange. When this takes the form of diffuse reciprocity – a gift of a cow, for instance, reciprocated by the gift of educating a child – this form of reciprocation can address the unpredictability of crisis [being tested to its limits in many African contexts today]. But a norm of reciprocal exchange can be difficult to achieve.

These three, hierarchical, collective - mutual and reciprocal are contrasting approaches with limited compatibility. One tends to drive out the other. Gift exchange is abandoned once people develop stable mutual assurance against particular risks. Mutual assurance schemes fade away when governments introduce state guaranteed programmes, or when large private agencies absorb them and their liabilities, to take a profit. There may well be efficiencies – a progressive reduction of transaction costs to the individual – in this progression;

1 Mary Douglas, Risk and Blame; essays in cultural theory. (1994) London, Routledge.

though oft-times these are more claimed than real. In any case individuals still take risks, so there is also an increased danger of moral hazard in this progression – individuals prepared to take greater personal risks because gain will come to them but the cost of failure will be borne in large part by others in the mutual or the state; the state being the tax payer in this instance.

The incompatibility of the three approaches to risk is also apparent in the internal workings of complex institutions. La Societe Generale, (SocGen) in France, in forensic examination of its lost billions [January 2008: Trading loss incident (Kerviel Fraud)] had to look carefully as to whether it truly was a lone individualist gambling with common pool resources that brought the society low or whether a group of insiders shared the perverse risks [of discovery] and gains from duplicity. [2]

The question that I am asking myself is this. Could a crisis call for a reverse of this direction? Where central regulation fails to capture and contain risks might positive steps to re-establish mutual investment between financial institutions work? Where risks are unpredictable but consequences great – leading to crisis – is building social capital through gift giving/risk sharing a possible step towards re-building social assurance?

At one level – the national or super-national level – the answer is obvious. Central financial institutions or governments 'give' when they intervene in troubled markets with interest rate adjustments, liquidity or changes in ownership. This is a system change, inviting if not introducing innovation. Wise professional heads have been counselling caution however. [3] To bail individual banks or persons out when they have taken excessive risks is simply to encourage them to go on doing so – the moral hazard issue. One question therefore is whether borrowers can be persuaded to risk-share by giving to each other in anticipation of challenging circumstances; a form of mutual assurance. [4]

2 Of course, gambling with corporate resources is what he was paid to do; but was supposed to stick within hierarchically established and monitored limits. Whether he did so stick and whether the hierarchy did so monitor are both being examined. Remembering that hierarchies allocate blame downwards, it is more likely that he goes to jail than that his bosses' heads roll.

3 Glen Hoggarth, Jack Reidhill and Peter Sinclair, (2003), 'Resolution of Banking Crises: a review' Bank of England Publications 2003.

Another question, to which I return in the final paragraphs, is whether banks and their clients, such as mortgage holders at the bottom of society society, can also share risks more equitably.

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The principle of risk sharing has deep social roots in all societies. It benefits individuals and is good for the wider community at least in one respect. To share risk protects the parties to the transaction but also safeguards the wider economy. Not to share risk is to invite collapse to both. Let me expand on this notion.

The situation has to be looked at from several perspectives, borrower, lender and the rest of us. [I leave aside the government perspective at this point.] Look at the first two first. There is an old truism. 'If you have a small debt and it goes wrong it is your problem. If you have a big debt and it goes wrong it is the lender's problem'. Many individuals have done well, in an expanding economy, by taking big mortgages and other loans, paying the interest, and capitalising on inflating asset values. If, through changes either in their personal circumstances or in the macro-economy, their borrowings suddenly become unmanageable, these individuals can suddenly be a problem not only to themselves but to the lending institutions from which they borrowed. For the banks 'prime' becomes 'subprime' without any change in the personal strategies of borrowers. So in a declining economy the banker's perspective needs an addition. 'Many small debts, however packaged and even with innocuous sounding titles such as "sub-prime", equal a very big one; and hence a big problem'. As for the rest of us, we have to face the fact that small problems between bankers and borrowers can turn into failing institutions, evaporating jobs, falling house prices …….

In this situation the Western banker's normal recourse is to foreclose on loans and seize assets. This no doubt works for the bank in a steady or expanding economy. However, in a declining economy seizing an asset actually decreases its value. Britain then faced a rising rate of house repossessions. What is a personal disaster for the individual defaulter on interest payments – the risk-taker who loses all – is not without a downside for the lender either as others default and more repossessed houses accelerate the slide in house prices. Market failure in this case takes the form of many [poor] people who need

4 Cattle owners in Botswana exchange cattle as mafisa 'the herded ones' sharing risk of drought, theft or disease. One party gives to the other, sometimes reciprocally, granting rights of use as well as a share of any increase, gaining the surety that these animals can be called back in case of need. A March 2014 news item stated that the European Banking Authority had established that European banks would in future be responsible for remedying bank failure within their membership.

houses being out on the streets without entitlements while empty houses – the real material assets - are possessed by banks, empty and almost valueless. This scenario might give us a second value worth pursuing: namely that money value and asset value should somehow be linked, one to the other; as it is asset value that matters to human well-being.

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Let us take these two principles or value objectives; (a) that risk should be shared and (b) that money value should be tied to asset value and see how they might be applied or re-applied to key elements of the economy. I single out; inter-bank relationships, householders and their financiers, managers and their corporate enterprises. I take them in reverse order.

Between owners or managers and their corporate employees in modern companies, risk and reward are defined through various forms of performance agreement as well as employment contracts. In the finance sector the size of both pay and performance related bonuses that senior managers have received has attracted extensive press commentary in recent years. Big salaries, bonuses and termination payoffs are justified through the language of risk. But the small print of the contracts seems to negate this language. A fixed bonus is an anathema. A proportional share in trading surplus is only justified as risk if the same share apportions potential loss. Profit taking without liability for potential loss passes the risk to someone else. The press protests at the severance contracts of the managers of failed institutions such as Northern Rock but does not go back to fundamentals. The fact is that the 'bosses' are not currently sharing risk. Their profit taking has contributed to house price inflation in London especially and to the continuing rise in expectations of rewards for what is essentially the same work – again detaching money from value. The first requirement of the re-establishment of trust within corporate institutions is the re-connection of reward and risk for senior management – like, if they are responsible for a risk gone wrong, they pay.

In the housing sector the principle that money transactions are about goods and services and not about money making money out of money would be honoured through co-ownership of the house. Co-ownership also achieves the principle of risks being shared equitably. A house owner who has taken money on risk-sharing terms has to recognise that this is investment and the lender has a share in the value of the house. Of course, the lender's share can be whittled down over time through paying back capital but if the value goes up the lender's share goes up. If it goes down the lender should share the decline. [5] If the owner has to sell up he/she gets the appropriate proportion of the sale at current value and so does the lender. The fact that financial transactions remain secured against assets rather than detached representations would discourage inflation and keep the economy in balance, which would be good for the rest of us. It would also be good for the bank. Instead of having non-paying mortgages littering its books it would have shares in houses, and houses have a use-value that is likely to be relatively constant. Of course there would be no quick buck for anyone either.

How to oblige banks to share liabilities rather that allow them to free ride on central government owned banks or the government itself, as lender of last resort, is a tricky one: the more tricky because it is not a new problem. [6] All banks are obliged by law and regulation to have deposits in central banks – a kind of obligatory sharing of risk. Governments have also established regulators and regulatory regimes that monitor individual banks, inspect their business plans and so on. For our other value; tying money value to asset value – a matter of inflation - governments these days attempt to control this through influencing the overall supply of money. All very complex, but when it works it works. When it doesn't work, as now, what is to be done? Is there a way of shoving responsibility back onto the banks; obliging them to look for inter-bank lending solutions?

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This discussion so far has explored ideas of risk sharing and of tying money-values to things-values. I would stick by my claim that risk-sharing is a fundamental feature of human societies everywhere and add that stable goods-values is just common sense. But I may as well reveal what prompted the above reflection. A rather long time ago - mid eighties I suspect it was - colleagues and I visited the newly appointed Chairman of an Islamic bank in Khartoum, Sudan. We knew him well. He had been a senior government official dealing with aid assisted projects and with public administration matters. He had always shown an admirable pragmatism in official matters and had a delightful philosophical turn of mind on the several occasions that he had invited us as his guests to The Sudan Local Government Officer's Club. [7]

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5 A way of periodically revaluing the asset and the shares of each party against current values would add to the equitability of the system.

6 Apart from anything else, the size of the liabilities of world-scale banks now dwarfs the ready funds available to any national government.

In taking up his banker role our friend, typically, had sought an understanding of the principles as well as the practice of Islamic banking – then expanding in the Sudan – and shared his thoughts with us. The principles had evolved, he said, to deal with such needs as financing trade, an inherently risky business. A ship might be lost at sea or captured by pirates. Two principles were apparent. The first is that money should be used to facilitate the exchange of goods and services, not to make money. The second is that risk should be shared equitably. To take interest on a loan regardless of the success or otherwise of the enterprise is to leave the risk entirely to the borrower. An Islamic banker should in principle share the risk of an enterprise by taking either profit or loss proportionally with the entrepreneur according to their shares in the venture. The banker takes equity rather than making a fixed interest loan because profit or loss is not knowable in advance. So attempts to agree a fixed return to the bank, to be taken before or after the course of the enterprise, are contrary to principle. But this does happen, he admitted. 'We are not perfect' said our friend. Imperfection acknowledged, in what follows I attempt to tease out these principles rather than to the particular practices that have emerged in recent years within the rapidly expanding Islamic banking system.

Whether actual Islamic practice is close to its stated ideal is a matter beyond my competence to determine. One crucial test is whether the banker shares the risk of the value of an asset, such as a house, going down. According to a Wikipedia article [8] – perhaps not the most authoritative source, but accessible – mudharabah is a profit sharing arrangement. It presumably allows for loss sharing as well as profit sharing. Mudaraba is seen as a venture capital deal in which all the funding comes from the lender who shares profits, and presumably losses with the person running the business. Murabaka, on the other hand, is described as a mortgage transaction in which the bank, instead of making a loan at interest to the purchaser, will buy the property from the vendor, add a charge and sell it back to the purchaser on instalments. Under this last arrangement the bank as owner would appear to be liable for any loss of value at the point of re-sale but would only share this loss with the lessee if routine re-payments were also allowed to decrease. If, in actuality, some forms of practice fail this test, as my Sudanese informant said; no system is perfect.

Of course the idea or practice of risk sharing is not confined in any way to Islam. A good idea that embodies mutual respect and equitable response to human

7 Valuing his reflective views we ensured that he became an Honorary Fellow of our UK University.

8 http://en.wikipedia.org/wiki/Islamic_banking

need is likely to have been discovered independently in different traditions and may simply need to be revived now. Post WW2 reconstruction in Europe saw bankers [and governments for that matter] taking equity in businesses on a large scale. In the housing sector co-ownership through cooperative housing or, more recently, through schemes sponsored by governments are well established practises. There are a host of potential institutional structures through which funders and property holders could share risks equitably and weather the storm. It would not surprise me if such mutual risk sharing arrangements will not be a part of the reconstruction after the downturn as the world economy bottoms out. But we are not good at institutional innovation and I will not be holding my breath.