

Theology and the Problem of Bias in Economics

My response today will consist of three parts. First, I'll provide an assessment of Dr. Cioni's presentation. Second, I'd like to pose a series of related questions to Dr. Cioni that will hopefully provide further clarification of his perspective. And third, as the lone theologian in this panel, I'll make some remarks as to the theological significance of group bias in economics in general, and in the subprime mortgage crisis in particular.

In short, I think Dr. Cioni's description of the situation is on target, and I'd like to add what economic data I can to support the thesis: Between 2004 and 2006, 12.7% of flexible-interest rate mortgages had negative 5% equity in their homes when the loans were made. In other words, their property was valued at five percent less than the value of the loan.¹ Such a toxic loan for a bank's balance sheets makes the most sense to me in an environment where borrowers, regulators, and banks had all assumed that housing values would continue to increase, thereby righting the upside down loans. After all, if the national average of housing values continued to rise at 16% annually as they did from December 2003 to December 2004, and again from December 2004 to December 2005,² then the loans would be righted within a year. I find that this data coheres with Dr. Cioni's proposal that there was group bias in the mortgage market prior to the crisis. Further, I'd like to compliment Dr. Cioni on a clear presentation of the way that each economic agent interacted through bias. The presentation was helpful to me and well presented.

¹ Dimitris N. Chorafas, *Financial Boom and Gloom: The Credit and Banking Crisis of 2007-2009 and Beyond* (New York: Palgrave MacMillan, 2009), 105.

² "Home Price Index." Federal Reserve Bank of New York.
<http://www.newyorkfed.org/home-price-index/> accessed 2/19/13

I would, however, like to ask a few questions in hopes of better understanding Dr. Cioni's position. My main question is as follows: Is there something particularly unique about the bias of the agents described by Dr. Cioni, or is this one example of broader phenomena studied by behavioral economists and seen across numerous markets? For example, most investors experience overconfidence.³ In fact, confidence itself can be understood as a psychological trust that allows for action without rational reflection.⁴ There is also the "house-money effect", which refers to the tendency of individuals who have already made a profit on an investment to take higher risks, as would a gambler who sees himself playing with the house's money.⁵ I'd like to know Dr. Cioni's opinion on the matter: Is there something unique about the general bias of the agents in the subprime mortgage crisis, or is this an example where we can point to common psychological factors playing a role in creating this and other biases? Was this example of general bias simply a result of 10 years of high profit in mortgage markets that led to overconfidence and the "house-money effect"? Or was there some unique cause of their bias? I believe the answer to these questions will be pertinent to my discussion of the theological significance of general bias in economics.

I'd now like to point to two fundamental areas where theology contributes to a discussion of bias in economics. I'll address theology's significance for the passions, and

³ Nofsinger, John R. *The Psychology of Investing*. (Upper Saddle River, NJ: Pearson Prentice Hall, 2005), 15-16.

⁴ "There is more to the meaning of *confidence*. The very meaning of trust is that we go beyond the rational. Indeed the truly trusting person often discards or discounts certain information. She may not even process the information that is available to her rationally; even if she has *processed* it rationally, she still may not *act* on it rationally. She acts according to what she *trusts* to be true." George A. Akerlof and Robert J. Shiller. *Animal Spirits* (Princeton: Princeton University Press, 2009), 12.

⁵ Nofsinger, 33.

theology in relation to what Lonergan calls common sense. First, the passions. In *Insight*, Bernard Lonergan explains that common sense has a necessarily subjective component because it does not just relate object to object, but rather object to subject.⁶ In light of this, Lonergan asks “Is the acquisition of common sense itself a change in us?”⁷ Both his ensuing discussion and my own studies have convinced me that the answer is yes.

Suppose that there are multiple “common senses,” that is to say multiple modes of practical knowledge within which distinctive individuals or groups can operate. If there were multiple “common senses,” then there would be in effect slightly different subjectivities arising within these varieties of common sense. Because general bias, according to Lonergan, is a byproduct of preferring common sense (i.e. a practical knowledge) over theory (i.e. more pure intellection with greater attention to the long run), bias can be seen as a result of a flawed or insufficient subjectivity within which intellection arises. But this is just another way of saying what behavioral economists have been saying all along: practical economic actions are often shaped to some degree by underlying psychological passions that inhibit clear thinking. Theologians have long attempted to describe the passions’ proper orientation and proper relation to the will and to reason. Insofar as passions are a subject of study in Christian theology, theology has a voice in economic matters. If Dr. Cioni is right, and I believe he is, then bias can be the source of major economic disruption. Perhaps one solution is to properly orient, subdue, and habituate the passions through Christian devotional, liturgical, and contemplative practices much as monastic orders have successfully done for centuries.

⁶ Bernard Lonergan, *Insight*. in *The Collected Works of Bernard Lonergan*, Vol. 3, Ed. Frederick E. Crowe and Robert M. Doran (Toronto, University of Toronto, 2000), 204.

⁷ Ibid.

This leads me to my second point concerning how theology relates to the problem of group bias in economics. If bias arises from common sense, that is, from specific modes of practical knowledge relating subject to object, then we can assume that certain varieties of common sense entail certain modes of discourse. Dr. Cioni identified several key players in the mortgage market, such as borrowers, lenders, arrangers, members of Congress, and so forth. Each of these players fulfills a socially delineated role that is derivative in part from their socially constructed title. Let's look at the case of a member of congress to consider how a title is socially constructed. First, we should note that any social reality depends upon certain conditions of possibility.⁸ A social reality emerges once these conditions have been met. For a Congresswoman these conditions are winning an election. Once this process has occurred, we recognize a Congresswoman as a Congresswoman even though there have been no corresponding physiological changes. Second, we should recognize that any socially constructed title carries with it a corresponding social function. The title "Congresswoman" is transferred not only because the conditions of possibility were met, but also in order to bestow certain privileges and responsibilities upon the bearer of that title. In this case, the Congresswoman has the privilege of directing public policy but the responsibility to do so for the benefit of the common good, or at least for the benefit of her constituency.

Dr. Cioni rightly notes that Congress struggled to regulate Fannie Mae and Freddie Mac because of cultural beliefs that affordable housing was an "unassailable good." Such a struggle on the part of Congress is most intelligible within the above discussion of socially constructed identity. Suppose the Congresswoman we'd mentioned

⁸ John Searle: "X counts as Y in C" John R. Searle. *The Construction of Social Reality*. New York: The Free Press, 1995.

holds the title “Congresswoman” as her most essential form of identity. To retain this identity, she must continually fulfill both the conditions of possibility (winning an election) and the socially derived responsibility of looking out for the common good. Out of these two needs emerges a practical knowledge, or common sense, by which a politician learns to act toward both the good and reelection. Subprime lending arose out of the group bias this common sense created. Members of Congress depended upon the support of a culture that viewed affordable housing as an “unassailable good”, and thus had to support subprime lending. But such lending could only be reconciled with the other half of congressional identity, acting for the common good, if prices increased. Therefore, the identity of “Congresswoman” or “Congressman” contributed to a group bias that caused people to both expect and act as if housing prices would definitely continue to increase.

How, then, do we overcome the social role? If some identities cause a group bias which results in actions that are actually counterproductive to the good, what can we do? What we need is another discourse, another source of identity.⁹ I submit that theology is precisely such a discourse, and that our identity in Christ is one of the few identities yet more powerful than political identity in this day and age. Returning to the example of the

⁹ A brief aside: I admit that it sounds as if I am suggesting the counter intuitive idea that a Christian identity would not cause us to affirm an unassailable right to housing. However, I am actually stating that the Christian identity could cause us to resist the temptation to push Fannie Mae into poor lending policies, or to insufficiently regulate this and other institutions. This is for three reasons: (1) the lack of “affordable housing” is in many cases created by actions contrary to the Christian identity in the first place, such as passing zoning codes or neighborhood regulations with the intent to raise housing prices and thereby restrict access to those deemed socially unworthy; (2) helping those in need to obtain “affordable housing” is only a good if pursued in such a way that the affordable housing will not be lost again three years later in a foreclosure; and (3) the general bias which helped many in the government to assume that housing prices must rise was predicated upon the identity described above.

Congresswoman, suppose she were to adopt a self-designation in addition to the title “Congresswoman.” Suppose this new self-designation, “Christian,” depended on different conditions of possibility, “the cross,” and entailed different responsibilities, “discipleship.” Suppose she held this self-designation more dearly than that of “Congresswoman.” In this situation, she could jeopardize her identity as “Congresswoman” by violating those social norms and risking the loss of an election if in doing so she was living into the higher identity of “Christian”.¹⁰ However, in so doing she could both address the underlying socioeconomic problems that create a need for “affordable housing” in the first place and prevent the pain caused by the collapse of a short-term solution such as subprime lending. In short, losing her identity as a member of congress, she would gain what she could not lose: the inalienable role of a daughter of Christ.

Now, to briefly conclude: I’ll state again that Dr. Cioni has written a clear paper whose thesis I fully support: general bias led in many ways to the subprime mortgage crisis. However, I hope I’ve been able to add the notion that this fact clearly shows the role of theology in economics. What we might call the “imputed righteousness” of a new identity as redeemed son or daughter of Christ, with a corresponding “imparted righteousness” through the development of virtue as a means to control the passions, both show the way forward in limiting bias’ harmful economic consequences. If bias arises out of an inadequately formed subjectivity, it is the role of the theologian to explore subjectivity’s proper formation as parts of the theological loci of creation and redemption.

¹⁰ Jurg Steiner searched for such a person in *Conscience in Politics* (Routledge, 1996)

Glenn Butner
3/1/13