

Why we should Elect Bankers

On the Moral Authority of Bankers

Boban Benjamin Braspenning

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4084438

Master Applied Ethics

Faculty of Humanities

Utrecht University

Thesis Supervisor: Ingrid Robeyns

Second Reader: André Krom

Abstract

The majority of money is not created by governments but by commercial banks. They do this when bankers provide loans to costumers which is credit. The conditions for access to credit are dependent on someone's creditworthiness. Since bankers formulate the terms of creditworthiness, they have a *moral authority*. Bankers make decisions on whom to include or exclude from credit. This is a matter of justice because people are increasingly dependent on credit as a source of income. In this thesis, I illustrate that the current fulfillment of banker's moral authority leads to increasing inequality and can function as a mechanism of structural injustice. Political mobilization against these injustices are hindered by alienating forces of newly adopted credit-scoring practices. Such practices improperly focus on individual responsibility and lack the ability to understand social contexts, both of which have an impact on creditworthiness. Bankers who want to fulfill their moral authority in a more justice-sensitive way, face the Schumpeter's Dilemma. This dilemma between distributive justice and economic stability can be tackled through the organization of social institutions. I present the Elected Banker proposal as a possible solution to these problems. In this proposal, bankers at the managerial level will be elected indirectly, based on economic expertise for a fixed period of time, by delegates from parties who take political stance in the credit-debate.

Preface

When I look at houses, I see large amounts of mortgage debts.

When I look at bank offices at, I see tax revenues.

Two types of money, of which only one has a democratic basis.

One year ago, in the Summer of 2018, I held an interview with a philosopher. We spoke about money. He was specialized in a relatively new terrain of ethics: banking. During that time I was an intern at Follow the Money, an online journalistic platform. I remember our conversation very well. Not because it was an exciting interview, rather the contrary. But because of one particular moment.

We sat outside in the burning sun, trying to make sense of our economy. I asked questions, he answered them. At least, most of the time. In our dialogue we came across a lot of issues: current ways of banking would destabilize the economy, cause housing shortage, strengthen inequality, cause environmental pollution and so forth. Many problems, few solutions. He wiped the sweat from his face and concluded: 'bankers just don't know what kind of influence they have on people'. The philosopher reinstalled his glasses and left a short a silence. 'Maybe it is just the banker who must change,' he said while staring at his drink. He got me thinking.

'Shouldn't bankers be electe-?' I asked. But before I could finish, the philosopher suddenly spat his Fanta on the ground. It was hard to tell whether he was shocked by the idea or simply choked.

He coughed and said: 'sorry, wrong throat... But go on.'

And that is what I did.

Table of contents

Abstract.....	4
Preface	6
Introduction.....	11
1.1 Credit Crunch.....	12
1.2 Money Creation.....	15
1.2.1 The credit-theory of money.....	15
1.2.2 Money and banking	15
1.2.3 Credit creation.....	16
1.2.4 Interest.....	18
1.2.5 Creditworthiness.....	19
1.2.6 Trust	20
1.2.7 General Trust.....	21
1.3 Conclusion.....	21
2.1 Why access to credit is a matter of justice.....	23
2.1.1 Why Bankers have a moral authority.....	25
2.2 Ethical Issues	26
2.2.1 Increasing inequality.....	26
2.2.2 Structural injustice.....	27
2.2.3 Alienation	29
The Feminist NOW movement.....	29
Alienation	30
The Community Reinvestment Movement	31
2.2.4 Political erosion.....	33
2.2.5 Statistical discrimination.....	34
2.2.5.1 Social salience	34
2.2.5.2 What is wrong with statistical discrimination	36
Summary	38
2.2.5.4 Big data.....	38
2.2.6 The Schumpeter's dilemma	39
2.3 Conclusion.....	42
3.1 Democratic equality	44
3.2 The proposal of an Elected Banker	45
Type of banker.....	45
Indirect election	46

Party system.....	46
3.3 Why bankers should be elected	46
3.3 Conclusion.....	49
Bibliography.....	51

Introduction

Scholars need to shift their focus from *redistribution* back to distribution itself. Nowadays, it looks like philosophers have developed a short-sightedness towards one of the biggest issues of distribution of our time, which is not taxation, but the creation of credit: a practice closely related to the profession of banking.

In this thesis, I argue that banking is a political matter with socio-economic consequences for society. Nowadays, however, it is primarily seen as an affair of business. Therefore, I will investigate how banking can be re-politicized. In doing so, I will make a case for one particular idea: the Elected Banker. In order to present this idea, I begin by giving a short overview of the financial crisis of 2008. I will elaborate on why the credit-crunch happened, how governments responded and how the crash was framed as a crisis of economic stability. Thereafter, I will discuss how credit creation works and what role banks play in this process.

In the second part of this thesis, I will build upon these empirical claims and conduct an ethical analysis. I will show that access to credit is a matter of justice and that the privilege to create and allocate credit gives bankers a moral authority. I will illustrate what kind of ethical issues arise from the current fulfillment of this role. Namely: increasing inequality, structural injustice, alienation and political erosion. I will also illustrate the dilemma bankers face if they want to give a more justice-sensitive interpretation of their moral authority. In doing so, I lay the foundation for the third part of this thesis. In the final chapter, I present the proposal of an Elected banker. I will elaborate on how this institution would look like and argue why it is a good solution for the ethical problems of banking.

1. Empirical Notions

1.1 Credit Crunch

At the beginning of this century, the housing market was considered to be ‘rock solid’. People believed trading mortgages would always be profitable, since economists, bankers and investors shared the widespread belief that the majority of people would follow up on their monthly mortgage repayments. They considered the risk of default on mortgages to be low.

In the 1980’s a financial process was invented that would nourish this belief. This innovation was called *securitization* or *risk-pooling*. With this practice, banks could combine multiple mortgages into a bundle. This way, banks were able to spread the risks of individual defaults. The risk of an individual not being able to repay their mortgage every month would be compensated by the ability of individuals that did repay their mortgage. This practice used the statistical *rule of large numbers* as a reason. By spreading the risk of individuals, the collective risk would be reduced (Heath, 2006, p. 322). At least, that was the intention.

Securitization allowed banks to present bundles of ‘bad mortgages’ as interesting investment opportunities¹. The practice gave banks the incentive to provide mortgages to more and more people, even the poor could receive one (Montgomerie, 2006, p. 301; 312). It was a dangerous development because in reality, although packaged as a low-risk security, the individual risk of poor people not paying back their mortgage remained high. Due to securitization, this risk remained unnoticed, with as a result more and more investors joining the mortgage market.

One of the reasons for this risk to remain unnoticed, was the role of *rating agencies*. These agencies arose in order to inform investors about the risk levels of mortgage bundles. If bundles had higher risks, the rating agencies would give it a corresponding low rating and if bundles had lower risks, the rating agencies would give it a corresponding high rating. At a certain point, however, these bundles became too large and complex to comprehend. High-risk bundles of mortgages were split up and bundled over and over again to spread the risk even further. The situation worsened when rating agencies became corrupt or were bribed to give high ratings. Thus, the ratings became detached from reality. Bundles of millions of people who had payment arrears or were using new loans to fund debts, would still receive a high rating.

It gave investors the impression that trade in these bundles was low risk, stable and highly profitable, while in reality the chance that it could be paid back in the future was very low (Polillo, 2011, p. 457). The mortgage market turned into a financial bubble: securitization led to a boom in share prices of ‘bad’

¹ Risk-pooling practices were also applied to other financial products, such as consumer credits or small business loans. In the case of mortgages these products were called Mortgage-Backed Securities (MBS) and in the case of other assets Assets-Backed-Securities (ABS).

mortgage bundles, resulting in risk-blind euphoric investment behavior (Kenton, 2018). Almost nobody saw the fragility of the system, let alone understood it. As Queen Elizabeth II captured it quite strikingly: “If these things were so large, how come everyone missed them?” (Telegraph, 2009).

Another reason for this myopia was a political ideal that arose: closing the gap in homeownership. In 2002, George W. Bush stated that everyone, regardless of their socio-economic background, should own ‘a piece of the American dream’. No matter what culture or class you were from, everybody should have a roof above their head. Securitization practices held the promise to realize this ideal. The practice was supposed to erase the inequality of access to mortgages. Its presumed homogenizing effect would make it possible for poor individuals to buy a home (Polillo, 2011, p. 457).

Bush’s ideal gave bankers the legitimation to provide mortgages to almost everyone, including to the poor. It was a dangerous development. If investors would get informed about the information that all these people were unable to repay their mortgage, they would lose their trust in the stability of the financial system. It would result in panic and a massive supply of mortgage bundles at any price. Supply would quickly outrun demand, making claims on future mortgage repayments worthless. Debt collectors would seize houses in order to keep something of value, and millions of people would become homeless. This was exactly what happened in the fall of 2008. The credit crunch became reality.

When the mortgage market collapsed, a bank-run arose. People lost faith in the financial system and tried to withdraw their money on a large scale (Kagan, 2019). But banks were unable to provide the paper money demanded by their customers. They simply did not have enough cash reserves. During this crisis it became clear that banks had too low capital reserves compared to their outstanding credits. The claims on money – such as claims on mortgage repayments – by far exceeded the actual money in reserves. No wonder that many banks that owned lots of worthless shares in mortgage bundles went bankrupt.

Collapsing banks posed a threat to the functioning of the economy. With money disappearing in thin air, the disruption of society lay ahead. The doom-scenario would be one of plundered supermarkets, unsafe streets and an anarchistic society. That is why governments concluded that banks were *too big to fail* and felt compelled to bail them out. They did this by injecting banks with public money: capital made out of tax revenues (Claassen, 2015, p. 527). In the years following the crisis, banks showed risk-averse behavior, making it difficult for people to receive mortgages or loans. Once again, especially the poor were being excluded (Streeck, 2015, p. 35). It was a harsh reality.

In the pre-crisis period, banks found a way to include poor segments of society into the mortgage market, enabling themselves to profit from poor people. During the crisis, these same people were put on the street and burdened with debts, while banks were saved with publicly paid tax revenues. After the credit crunch, the poor and lower-middle class segments of society were largely being excluded from loans and

mortgages once again, due to risk-averse behavior of banks (WRR, 2019, p. 127). After years of privatizing profits, losses were now socialized.

“The dream has been that access to the right kind of credit would allow Americans to make investments that increase security, freedom, and democracy; the nightmare that has all too often ensued is one of generalized risk, insecurity, and dependency.” (Dwyer, 2018, p. 240).

Remarkably, in the past years the credit-crisis has primarily been considered as if it was a crisis of stability. Therefore, most of the measures to remedy the crisis concentrated on re-stabilizing the financial system. Although people also began to question the current monetary system and the way in which credit is created, it seems that the debate primarily focused on the stability of the system. However, it was not solely a crisis of stability, it was an ethical crisis too. It was not solely a market failure, I would like to argue that it was a ‘justice failure’ as well (Singer, 2018).

The statement that the crisis was a matter of justice has everything to do with the essence of banking: *creating money*. The creation of money is the primary practice of commercial banks, their core business. Up to the present day, this government-received privilege follows a market logic, leaving the political aspect of banking underexposed. The creation of money by banks – lending mortgages and loans to the public – has distributive effects on society. Those people deemed worthy of mortgages or loans will receive credit; those deemed unworthy will be excluded from accessing these vital economic resources. In the following chapters I argue that banking is a matter of justice that should be re-politicized. In order to do so, I will begin by explaining how banks create money.

1.2 Money Creation

I will start this chapter – which has a more empirical nature – by explaining my perspective on money. Next, I will focus on three aspects of banking. First, I will elaborate on how the majority of money is created by commercial banks granting loans. Second, I will explain how banks charge interest over the created amount of credit and how this interest is differentiated and distributed among those who apply for a loan: through an estimation of individual creditworthiness. Third, I will explain the role of ‘trust’ in the stability of credit and how trust is influenced by the inclusion and exclusion of different people. This section sheds light on these processes in order to create an understanding of what banking is, allowing me to address the ethical issues and dilemmas of the creation of money in the next chapter.

1.2.1 The credit-theory of money

Different perspectives on money exist, each embedded in a historical context. This thesis uses the perspective in which money consists of a debt-relation between creditors and debtors, respectively between banks and costumers (WRR, 2019, pp. 22, 27); (Keynes, 1930, p. 4). Using this perspective, I build upon the ‘credit theory of money’, also known under the name of *Chartalism* (Bell, 2001, p. 150). This theory is contrary to the ‘commodity theory of money’, which sees physical coins and notes merely as tokens of a more abstract social construction in a market based-society: following the idea that money is only worth something because there is general agreement it has an exchangeable value (Bruin, 2018, p. 1.1). This ‘medium of exchange’ conception holds that almost everything can function as money, as long as it is recognized as such. Several famous examples exist of past societies that used shelves or giant rocks as money (Fitzpatrick, 2004, pp. 18-20)

The chartalist theory, however, is not preoccupied with the medium of exchange function of money. The theory also tries to uncover the essential properties of money as a unit-of-account and a means of payment (Bell, 2001, p. 154). In order to do that, it focuses on the social and historical origins of money. Some of these essential properties are that money should be recognized by government and that one’s earning and holding of money should be eligible for taxation. These properties show the neglect of commodity theories: a giant rock is difficult to tax, so are many cryptocurrencies, even though they serve the medium of exchange function. Credit, however, *is* a form of money that is recognized by government and is eligible for taxation. By taking historical and social factors into consideration, the chartalist perspective *can* provide a non-market based theory of money (Bell, 2001, p. 154). In the following chapters, I will build upon this non-market based conception.

1.2.2 Money and banking

In monetary economics a distinction is made between several monetary aggregates: M1, M2 and M3. The first aggregate is the narrowest conception of money. It includes hard cash as well as cashless credits that can be used to pay with. M2 contains hard cash, cashless credits, deposits with a duration of less than two years and deposits with a notification period of less than three months. The last definition M3 is the

broadest conception. It contains the definitions of both M1 and M2 and is supplemented with repurchase agreements, shares in money market funds and debt-securities with a duration of two years. In this thesis, I will refer to the monetary aggregate M3 when I speak about money. Following this conception, I share the wide-spread assumption that 93% of all the money is a form of debt. This debt consists for 39% of credits, for 51% of saving deposits and for 3% of other financial services (WRR, 2019, pp. 23-24). Although many different forms of credit exist, I will focus on the similarities rather than the differences (Herzog, 2017, p. 412). This allows me to speak about banking in general terms.

The definition I use for the term 'banking' is inspired by the following quote: "(...) bankers incessantly create money through the lending process. (Minsky 1986; Moore 1988; Schumpeter 1911) This is an *ex-nihilo* accounting operation, a balance sheet expansion: it is a simultaneous act of crediting the client's account (thus creating a liability for the bank) and crediting the bank for the amount of the loan (thus creating an asset for the bank)." (Polillo, 2011, p. 443). In the following paragraphs, I will dive into how the credit-creating practices of banking works.

1.2.3 Credit creation

The vast majority of money – 93 percent – is not created by governments² or central banks, but by commercial banks. They do this when providing a loan to someone: a mortgage, consumer-credits or a business loan. Such loans are made out of *credit*: something which we can use as money but simultaneously is *debt*. Commercial banks are able to create credit, seemingly out of nothing (McLeay, Radia, & Thomas, 2014, pp. 11-12). The first thing required to do this, is a demand for credit (WRR, 2019, p. 40). This can best be explained by using a bank balance in figure 1 below. On the left side of the balance, the *assets* of the banks are displayed. These consist of central bank reserves, provided loans and government bonds. The right side of the balance displays the *liabilities* of banks. These consist of private equity of the bank³, debts to other banks (including the central banks), savings from costumers, and payment credits to costumers.

² It is a common mistake to think this is the case in modern society. The macroeconomic term for this idea is called 'Chartalism' and goes back to the economist George Friedrich Knapp's *The State Theory of Money*, which was first published in 1905.

³ Banks need to have private equity on the liability side of the balance sheet in order to guarantee they can pay some people back if they have to (WRR, 2019, p. 40).

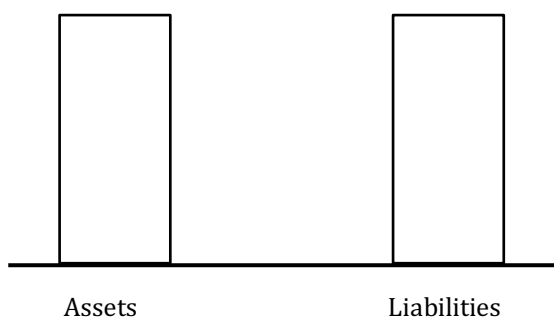


Figure 1. An abstract representation of a bank balance sheet

Credit is created as follows. When Pascal wants to borrow €4000 euros for buying a motorcycle, and if he is considered ‘creditworthy’ (a concept I will elaborate on in a later section) a bank can issue this money, increasing the credit of Pascal with €4000. This is a liability from the bank towards Pascal, therefore the right side of the balance increases with €4000. Simultaneously, a debt is created from Pascal towards the bank. The bank accounts this debt as an asset. Therefore, the left side of the balance increases with the same amount. Now Pascal owes the bank €4000, including interest. Credit can also be destructed. This happens when Pascal repays his debt. If he pays back €400, then the liabilities side as well as the asset side of the bank balance decrease with €400. Although credit is created in other ways too⁴, this scenario in which commercial banks provide loans to costumers is the most voluminous one (WRR, 2019, pp. 37-41).

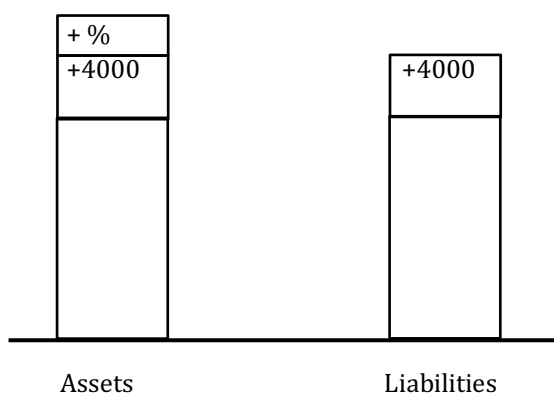


Figure 2. Extension of a bank balance

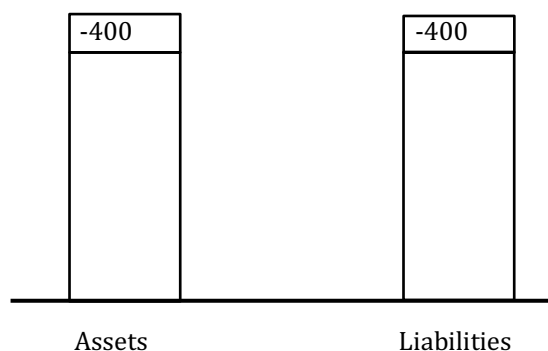


Figure 3. Shortening of a bank balance

⁴ Such as when banks buy or sell financial products from non-banks or when the European Central Bank (ECB) creates credit for their Quantitative Easing program: a practice in which the ECB purchases government- or market securities in order to increase the money supply and encourage lending and investment (Chappelow, 2019).

It can be difficult to comprehend what credit is and where it comes from. For some, it might seem puzzling that banks can create money out of ‘thin air’. However, banks cannot create credit entirely out of nothing. It is important to keep in mind that the first thing required to create credit, is people applying for a loan. What these people offer is a promise of repayment, which usually comes down to *future labor*. Without this element, credit cannot be created.⁵ Thus, credit is never created overnight, in order create credit, something must always be offered in return.

Not only the creation of credit is unclear to some, even credit itself may be considered a vague concept. For some it helps to see credit as exchangeable for banknotes. Or put differently: a promise from the bank that you can withdraw credit for cash money. Thereby it is important to remember that the amount of money directly available in cash is many times lower than the amount of credit. When too many people want to withdraw their money a bank run can arise. For others it helps to see credit as nothing more than a debt-contract: a credible promise of providing and repaying money upon which can be built.

1.2.4 Interest

The dynamic in which the bank has a liability towards Pascal to provide exchangeable credit while simultaneously Pascal owes the bank debt, can be described as a ‘mutual debt acceptance’. It looks like these two forms of debt mirror each other, but they differ in several aspects. The debts from costumers towards banks often have a longer duration, have to be repaid on a periodical basis and must be paid back with interest. The debts of banks towards costumers, however, have no fixed period in which it must be repaid, should be withdrawable at any moment and can be used by costumers to make payments (WRR, 2019, p. 43).

Since credit simultaneously is debt, it must be repaid in the future (Bell, 2001, p. 150). Generally, banks oblige people to pay interest on the borrowed amount⁶ (Polillo, 2011, p. 443). Interest is a revenue model for commercial banks. Whenever the interest to be received by banks is higher than the interests to be paid on customer savings, they can make a profit⁷. Banks call this the ‘interest margin’ (McLeay, Radia, & Thomas, 2014, p. 12); (WRR, 2019, p. 43).

Banks determine the level of interest based on their criterion of *creditworthiness*: the estimated probability that someone is able to repay the borrowed amount of money (Polillo, 2011, p. 444). Someone who is estimated to have a high degree of creditworthiness, is considered by banks as a low-risk investment. Therefore, it is relatively easy for this person to receive a loan against a low interest rate. However, for people not considered creditworthy, it is the other way around. From the perspective of the bank, people that are less creditworthy are a relatively risky investment, making it difficult for this group to receive a

⁵ Except for central banks, they can create credit for their covered bond purchase programs (CBPP).

⁶ In order to create income or make a profit, to compensate for risk or to calculate the intertemporal value of money (inflation).

⁷ Banks are therefore busy with attracting new credit and saving accounts. This is however not necessary to create a new loan (WRR, 2019, p. 42).

loan. In addition, when banks are willing to grant this group a loan, they have to pay a higher interest rate (Polillo, 2011, pp. 437-444) (Meyer, 2018, p. 304).

1.2.5 Creditworthiness

The levels of these interest rates are in part⁸ determined by bankers' risk-assessments. Taking together, the risk-assessments determine someone's creditworthiness. Creditworthiness can be described as follows: 'the set of rules and criteria that delineate the boundary between those who are worthy of holding a particular currency and those who are not.' (Polillo, 2011, p. 438).

Two financial criteria are particularly important in estimating someone's creditworthiness: the level of *solvency* and *liquidity*. To be solvent, someone's assets must be at least as valuable as someone's liabilities. Put differently, someone's income must be high enough to cover someone's expenditure. To be liquid, someone must be able to meet financial liabilities when they fall due. This means: having the money at hand when you must pay for something like rent or invoices. Note that someone can be solvent yet illiquid. A bakery can be able to pay its fixed costs for dough but at the same time lacks money to make investments in baking machinery. Assuming the solvent bakery would have the machinery, its profits would rise to such an extent that the costs could easily be covered in the future. But without being granted credit first, the bakery would nonetheless be illiquid (Meyer, 2018, p. 309).

Estimating someone's creditworthiness is a banking practice that has developed over time. In earlier stages of banking, creditworthiness was determined through the so-called 'connections strategy'. Bankers tried to gather information from social networks of potential borrowers in order to assess the likelihood of repayment. After doing this research, bankers performed an evaluative credit screening. These face-to-face interviews with loan applicants allowed bankers to weigh relevant factors. Often this approach created a 'gut feeling' on which bankers decided whether to grant a loan (Krippner, 2017, pp. 17-18).

But over the course of time, this subjective approach turned out to be unreliable and sometimes discriminatory. Therefore, it was replaced by so-called 'credit scoring' practices. Estimating someone's creditworthiness became a more mathematical matter. To create credit scores, bankers constructed an index of borrower characteristics. The weight that each characteristic added to the predictive power of the index, determined the point score (importance) of the item. Think of characteristics such as educational level, marriage, delinquency and place of residence (Krippner, 2017, p. 18). People who would receive a score above a certain threshold would receive credit and those below the threshold would be denied access to credit.

However, problems with credit scoring practices arose. Although the attributes for the credit scores were predictive, they were not explanatory. It was not necessary to establish a causal relationship between the

⁸ Interbank loan rates, for example, also play an important role.

potential borrower and his 'credit behavior', or at least, not from the perspective of the bank. They found that a correlation with the credit behavior of other individuals who had the same characteristics, was sufficient for estimating someone's credit score (Krippner, 2017, p. 18). The logic of credit scoring was to parse risk more finely, so that the gap between the aggregate category and the person could be closed (Krippner, 2017, p. 19). This objective laid ground for a further removal of credit scores from the behavior of the borrower.

In the beginning of credit scoring, the scores were determined individually by analyzing internal databases. But later, credit scoring became standardized. Through standardization, estimating data scores did no longer depend on each bank's separate internal database. Instead, large bureaus created bigger databases and developed aggregate credit profiles, accessible to banks. By doing this, it became easier for banks to exercise judgments in credit risks (Krippner, 2017, pp. 18-19).

Nevertheless, some segments of society remained not eligible for credit. In order to include these 'unscorable costumers', a new practice arose. More recently, credit scoring companies and banks are trying to understand how people behave online. They do this through the usage of big data (Berg, Burg, Gombovi, & Puri, 2018, p. 6; 28). Since more and more digitally provided information can statistically determine the likelihood of repaying credit, banks found new ways to estimate people's creditworthiness (Gillespie, 2014, p. 174). Using algorithms that combine data such as loan-histories, online behavior and choice in mobile phone types, banks are able to include and exclude new or unknown categories of potential borrowers. These kinds of proxies together form the so-called 'digital footprint' of people (Berg, Burg, Gombovi, & Puri, 2018, pp. 2-3; 11). Although banks profiled, segmented and managed potential borrower through the usage data for a long time, it is more recent that these processes have become more precise, widespread and routinized. Algorithms play an important role in shaping these processes (Kitchin, 2014, p. 17).

Finally, in order to apply criteria of creditworthiness as a bank, the bank itself must be creditworthy: it must build a *reputation* for itself so that borrowers and creditors are willing to do business with it. In order to build this reputation, a bank must make certain lending decisions by subjecting them to rules and standards (Polillo, 2011, p. 444). In other words: a bank must build a reputation of trustworthiness.

1.2.6 Trust

The value of credit is always uncertain since it depends on future economic activities. In other words, it depends on the general trust people have that the amount of money that has been borrowed will be paid back. Therefore, banking operations, like establishing someone's' creditworthiness, have a fiduciary character: in order to gain trust, bankers predict the likelihood that a debt will be repaid (Ingham 2001; Minsky 1986, cited in Polillo, 2011, p. 444). Due to the 'temporal character' of credit, bankers are exposed to both uncertainty and vulnerability: they don't know if the borrower repays and they are exposed to loss when she does not. Generally, two strategies are used to cope with this uncertainty.

The first strategy is the so-called ‘connections strategy’. It refers to lenders’ attempts to reduce uncertainty by gathering information from borrowers. Traditionally this was being done through informal personal connections, in form of credit reports, but later on the more formal organizational tool of credit scoring took over. The second strategy is called the ‘collateral strategy’. This refers to the attempts of bankers to convince their customers to use valuable possessions – such as houses, inheritance or others forms of capital – as collateral for the costumers’ loans. Since collateral almost never fully covers a loan, there are requirements that impose a loss on the borrower in the event of default. The underlying thought for doing this is to align the incentives of the borrower and the lender in advance, so that the promises of repayment can be trusted upon (Krippner, 2017, pp. 8-9).

1.2.7 General Trust

Trust is crucial for the functioning of money and the provisions of loans. The financial crisis of 2008 has negatively affected this trust (WRR, 2019, p. 28). When we look at the situation in the Netherlands, it becomes clear that the general trust in the banking sector is relatively low compared to other institutions. Furthermore, the trust among highly educated people is higher than among the lower educated. Economists seem to have a lower trust in the stability of the banking system than the public has.

The trust people have in the stability of money seems to be closely related to trust in other institutions: in policy makers, politics, the (future) economy, the public, central banks and bankers. Therefore, distrust in money also affects the trust in other people. Trust cannot be enforced but needs to be given. Trust must be earned by proving to be trustworthy: meeting justified expectations. In addition, it is important to be able to articulate dissatisfaction. The general trust in the credit system can be seen as a combination of the level of servitude, stability and justice (WRR, 2019, p. 29).

1.3 Conclusion

In this chapter I articulated that I follow the ‘credit theory of money’. I clarified that the majority of money is created by commercial banks when they provide loans for costumers, under the condition that these customers are creditworthy. Based on the level of creditworthiness, the level of interest on the borrowed amount of money is determined. How creditworthiness is determined, is a banking practice that has developed over time. In the beginning it was dependent on information provided from social networks of loan applicants, later this practice became a matter for which algorithms were used more often. Furthermore, I explained that the value and stability of credit is dependent on the concept of trust. In the following chapter I will explain why credit creation and allocation is a matter of justice. In addition, I will illustrate what kinds of ethical issues arise from the way in which money is created.

2. Ethical Concerns

In the previous chapter I explained how commercial banks create credit. This process may still be puzzling to some. Although I share the fascination of how the majority of money is made, I will not go into the technical specifics of this practice. Instead, I will focus on a more fundamental aspect of banking. Since we can agree on how money is made, the question remains why it would be an issue that deserves *ethical* consideration. In this chapter I will try to answer that ‘largely unaddressed’ question (Herzog, 2017).

I begin by explaining why access to credit is a matter of justice. Next, I clarify the role bankers play in this issue. Due to their privileged position to create credit, I argue that bankers have a *moral authority*. After explaining how this role is fulfilled, I will illustrate what kind of ethical issues arise from the current creation and distribution of credit.

The first issue is that of *increasing inequality*. I will show how inequality is created and argue why it is a matter of *structural injustice*. Next, I explain how credit-scoring practices lead to *alienation* and why this is problematic. I do so on the basis of two examples from the late 20th century United States. In addition, I argue that these alienating effects erode the possibility for debtors to make *political demands*. After emphasizing the importance of political mobilization, I will argue that it is endangered even more. I point towards algorithmic decision making-, statistical discrimination- and reliance on big data in estimating creditworthiness as the main reasons for this threat.

I conclude this chapter by illustrating an important dilemma that bankers face. A dilemma between their public and private role and a dilemma between justice and stability: the Schumpeter’s dilemma. In doing so, I lay the foundation for the final chapter.

2.1 Why access to credit is a matter of justice

Access to credit is a matter of justice for several reasons. First of all, credit is an increasingly important source of income to people. In order to fully participate in a capitalist society, access to credit is needed (Meyer, 2018, p. 307). Credit enables citizens, companies and other organizations to make payments, to save money and to finance themselves (WRR, 2019, p. 107). Without a mortgage, it is almost impossible to buy a house, and without a business loan, it is difficult to start a business. There are few alternatives to guarantee the same kind of inclusion to the market economy (Meyer, 2018, p. 311). Moreover, in the last decades, due to the stagnation of real wages and the cutback of public services, it has become harder and harder for many people to cover basic needs without making debt (Herzog, 2017, p. 415). One could therefore claim that access to credit functions as a ‘prerequisite for full inclusion on the marketplace’ (Krippner, 2017, p. 2). It could typically be seen as a part of the *basic structure of society* as defined by John Rawls, since it has a pervasive impact on people’s life (Rawls, 1999, p. 6).

Secondly, access to credit is a matter of justice because it has a liberating potential. Credit enables people to structure their budgets over their lifetime. It allows someone to spend money intertemporally. The possibility to repay credit in the future helps someone to overcome *liquidity constraints*. This enables millions of people who are solvent yet illiquid, to buy a home or to start a business (Meyer, 2018, p. 309). In other words: access to credit ‘(...) offer individuals the opportunity to live their life according to their own preferences, even if their budgets have the “wrong” temporal structure’. (Herzog, 2017, p. 412). It is because of this liberating potential, that the question whom to include or exclude is a matter of justice.

Third, access to credit is a matter of justice because it shapes class situations and life-chances in society (Krippner, 2017, p. 36). Access to credit against proper conditions is instrumental for creating income and advancing economic development (Hudon, 2009, p. 19). It therefore influences the “capabilities of people to lead the kind of lives they value” (Sen 1999, p. 19 cited in Lastra & Brener, 2017, p. 50). These ‘capabilities’ reflect someone’s freedom to choose between different ways of living and also reflects the combinations of so-called ‘functionings’ (doings and beings) he or she can achieve. Being able to achieve this capability influences someone’s quality of life (Sen, 1990, pp. 43-44). This seems to be the case for the creation and distribution of credit, especially since an increasing amount of research shows that access to distinct types of credit against differentiated conditions leads to differentiated life chances (Dwyer, 2018, p. 243).

Furthermore, access to credit may not only affect quality of life in terms of life chances, but also in terms of life-expectancy. In addition to financial effects, conditions for credit access also affect physical and mental health (Dwyer, 2018, p. 245). Research shows that the income-level of persons are determinants of their life-expectancy (SCP, 2018, p. 129). Low-income people live on average five years shorter than those who have an average or high income. Furthermore, the difference between the number of healthy life years between people with a low and high income is fourteen years in favor of the latter (CBS, 2009, p. 9).

The above should clarify why access to credit is a matter of justice. In this thesis, we could see access to credit as ‘the currency of distributive justice’ which can take the form of a *primary good* in the Rawlsian sense or the form of a general *resource* as described by Dworkin (Timmer, 2018). Logically, the conditions for access to credit and the distribution of credit are matters of morality as well. In the following paragraph I will argue that the ability of bankers to determine who is creditworthy and who is not gives them moral authority.

2.1.1 Why Bankers have a moral authority

Banks are making distinctions between individuals who are to be trusted with credit and those who are not worthy of this trust. As I explained earlier, banks do this by creating criteria of creditworthiness. This gives banks a ‘moral authority’: bankers make judgements of people which makes the lives of these people either harder or easier (Polillo, 2011, p. 437). The fulfillment of this authority roughly follows the following logic.

A profitable strategy for banking is to enforce existing boundaries. Those who are already worthy of credit – people who have a high education, a decent job, capital or collateral – are reliable costumers. They can be seen as “safe investments”. There is little risk in providing credit to these people, since the probability of repayment is higher than of those who are less worthy of credit: people who did not enjoy a high education, have no decent job and no collateral. This way of banking can be defined as the ‘gate-keeper’ strategy (Polillo, 2011, p. 445); (Herzog, 2017, p. 429).

Furthermore, the rules banks use for providing credit routinizes general lending decisions and therefore complicates the development of other lending procedures. In other words: “(...) the terms upon which borrowers gain loans, also restricts the ability of new actors to enter the banking business” (Polillo, 2011, pp. 444-445). Thus, lending practices of banks are not only reinforcing socio-economic differences but are also *self*-reinforcing. Therefore, it is unlikely that the current way of banking, along with the current fulfilment of the moral authority, will change any time soon. Nowadays, only the banks who exclude poorer segments of society are likely to build a trustworthy reputation. The effects this has on society become clear when we look at the way banks charge interest rates.

2.2 Ethical Issues

2.2.1 Increasing inequality

Now that I clarified how credit creation by banks leads to the inclusion of those who are well-off and the exclusion of those who are the least-off, we turn to why this increases inequality. The difference between these two groups is catalyzed by the level of interest rates on credit. Those who are ‘worthy’ will be attracted with lower interest rates, and those who are ‘unworthy’ will be kept out or have to compensate their degree of risk by paying higher interest rates. Even if less wealthy applicants are successful, against the odds, they need to accept these higher rates (Meyer, 2018, p. 304).

One could argue that the manner in which money is created is contradictory to the way we collect taxes: *the weakest shoulders carry the heaviest loads*⁹ (Booth, 1994, pp. 215-216). This initial distribution of money is contrary to John Rawls’ *Difference principle*: the people who are the least well off are the worst provided with the institutional design of credit creation (Rawls, 1999, p. 67). Banking practices incorporate already existing socio-economic distinctions between individuals, making it harder for the more unfortunate to get access to credit. It was Lisa Herzog who offered a striking description of this dynamic.

“For some individuals, mortgages and other forms of credit are a tool for improving their welfare and climbing the social ladder, but for others, typically less privileged ones, they are part of a cycle of poverty and over-indebtedness”. (Herzog, 2017, p. 430).

One could argue, however, that these inequalities are not unjust, simply because closing credit contracts is not mandatory. People voluntarily agree upon closing these contracts. The less wealthy are not coerced into closing a mortgage against higher interest rates. Therefore, the resulting inequalities are not wrongly imposed. I will call this the ‘free choice argument’.

When looking more closely to this argument, it becomes clear that it follows a free-market logic. The distribution of goods [credit] is governed through factors for which individuals are *personally responsible* (Anderson, 1999, p. 308). Ronald Dworkin for instance, would say that inequalities are justified as long as they are a product of personal responsibility: ambitions, decisions and intentional actions of those concerned (Gosepath, 2007). Many economic models share the tendency to ascribe market outcomes [like economic inequality] primarily to the choices of individuals. These theories typically see the creation and distribution of credit as the closing of debts-contracts between private individuals and financial

⁹ In most western taxation systems, it are ‘the strongest shoulders that carry the heaviest loads’. Therefore, one could argue that the resulting economic inequality from credit creation is not worrisome since the way we collect taxes and distribute public revenues has a leveling effect: created inequalities by banks will be corrected by the state. To make sure this is the case, we should compare the amount of money that is created on a national level on a yearly basis – which follows the ‘weakest shoulders, heaviest loads’ principle – with the amount of money that is collected through tax revenues each year – which follows the ‘strongest shoulders, heaviest loads’ principle. By doing this, one could get insight to what extent taxation corrects the inequalities created by credit. If taxation does not correct inequalities, credit creation issues should receive more attention. In order to solve this important yet complicated calculation, future research is needed.

institutions (Herzog, 2017, p. 414). Closing such contractual agreements is not considered compulsory. Rather, it is seen as a matter of free will.

But this is a false dilemma. A dichotomy between voluntariness versus coercion in the case of credit access does not hold. Against many debt-contracts that cannot simply be described as coerced, there are many debt-contracts that cannot simply be described as 'freely chosen' (Herzog, 2017, p. 415). Since many less-wealthy people lack decent alternatives for gaining income, they are increasingly dependent on credit. They cannot be held entirely *responsible* for closing credit contracts against stricter conditions when they have no better options. "(...) Free choice in a set of options, does not legitimate the set of options itself",¹⁰ Elizabeth Anderson would say (1999, pp. 308-309).

The free choice argument would typically work as a starting-gate theory: if people enjoy fair shares at the start of life, it does not matter much to what extent people would suffer from their own voluntary agreements in free markets (Anderson, 1999, p. 308). Unfortunately, that is not the case for the distribution of credit. In contrast, creditworthiness mechanisms rely on differences in socio-economic starting positions.

Thus, the distribution of credit – different than what the free choice argument suggests – is governed through factors for which individuals *cannot* be held personally responsible. People cannot be held entirely responsible for 'the set of options' they receive in applying for a loan. This depends on their creditworthiness, a criterion for which they also cannot be held fully responsible. This might need some explanation: one cannot be held accountable for being born in a socio-economic good or bad environment. Neither can one be held accountable for one's gender or skin-color, let alone be held accountable for how society or banks currently value these characteristics. These are products of different innate provisions, natural gifts and brute luck. Not of responsibility or ambition. Therefore, both Rawls and Dworkin would stamp these inequalities as unjust (Gosepath, 2007).

Nevertheless, the institutional design of creditworthiness uses these kinds factors as determinants for the distribution of credit. As a result, it not only imposes differentiated conditions for credit-access on arbitrary grounds, but it also creates a community in which people stand in relations of inequality with each other (Anderson, 1999, p. 289). It thrives on making distinctions between people in terms of moral worth based on birth or social identity (Anderson, 1999, p. 312).

2.2.2 Structural injustice

Thus, solely looking at individual responsibility is insufficient for understanding why the inequality imposed by banking is unjust. If we do want to understand this, we should focus on the *social position* in which individuals find themselves as well. In doing so, it becomes clear that access to credit is not merely

¹⁰ In the case of credit creation, it is not so much the 'free-choice' component that I'm concerned with. It is rather 'the set of options' – the conditions for access to credit – and how these are distributed among society which draws my attention.

a matter of justice in single occurrences, but rather a mechanism of *structural injustice* towards social groups (Herzog, 2017, pp. 415-418). Iris Marion Young defined this concept as follows:

Structural injustice ... exists when social processes [estimating creditworthiness] put large groups of persons [the less wealthy] under systematic threat of domination or deprivation of the means [credit] to develop and exercise their capacities, at the same time that these processes enable others [the rich] to dominate or to have a wide range of opportunities for developing and exercising capacities available to them. Structural injustice occurs as a consequence of many individuals and institutions acting to pursue their particular goals and interests, for the most part within the limits of accepted rules and norms (Young 2011, p. 52 cited in Herzog, 2017, p. 414).

What makes this injustice structural, has partly to do with its generally ‘accepted’ character. In order to oppose structural injustices, these norms should be challenged. A striking example is given by Krippner (2017) when she quoted a banker in the 1970s who replied to accusations of discriminatory practices against women in the credit market:

“Why have we continued to carry the account in the name of John Doe rather than Mary Doe? Frankly, because the vast majority of our customers want it that way, and because the vast majority of our customers have pointed to the husband as breadwinner and bill payer. The habits, mores, and legal restrictions of our society have placed creditors in the position of having to favor the male.” (Krippner, 2017, p. 15)

As this quote shows, already existing inequalities can be rearticulated through banking. This makes such injustices structural. It reproduces different initial socio-economic starting positions amongst people. This makes future generations once again subject to the natural lottery and victims of brute luck, since your starting position is not dependent on personal merit but on birth (Gosepath, 2007).

Therefore, the maldistribution of credit could also be seen as a *distributive justice failure*. It is the result of a market architecture that produces undue material inequality and policies that give undue advantages to certain parties over others (Singer, 2016, p. 112). In this case, the material inequality would favor the rich and disadvantage the poor, favor the well-off and disadvantage the least-off, favor the liquid and disadvantage the solvent and as a consequence sometimes even favor the less gifted and disadvantage the talented (Meyer, 2018, p. 309). Especially the last one would be against Dworkins’ notion that inequalities are just if they are the result of different ambitions, decisions and intentional actions (Gosepath, 2007).

From the above should be clear that credit creation not only generates inequality in terms of resources – how much money one receives – but also inequality in terms of social relations. The relationship within which goods are distributed is a fundamental concern. The credit-debtor relationship typically contrasts human diversity hierarchically. It moralistically contrasts the rich from the poor, the responsible from irresponsible, and the independent from the dependent. By doing so, it denies an equal moral worth of persons (Anderson, 1999, pp. 308-314).

In the following section I will show how we can tackle structural injustices. In order to do so, I will use two examples of credit activist movements in the late 20th century United States. In both cases, groups of people mobilized themselves in order to make political demands. In doing so, they experienced resistance from banks. These examples show the tendency of modern practices for estimating creditworthiness to alienate people's statistical relevant characteristics from their social contexts.

2.2.3 Alienation

In this section, I will provide two examples of credit-activist movements. I borrowed these examples from Greta Krippner (2017), who did a great job in exploring democratic manifestations in the credit market. In her *Democracy of Credit* she compares the labor-relation between employer and employee with the credit-relation between creditors and debtors. She does this because people are increasingly dependent on credit next to labor as a source of income, while at the same time they enjoy fewer rights in the credit market as they do in the labor-market.

The first example is that of the early 1970s American feminist movement 'NOW', which wanted to end gender discrimination in obtaining credit. The second example is that of the Community Reinvestment Movement that emerged in the late 1960s and early 1970s in Chicago. Both examples show the importance of collective action when making political claims in the banking sector. They also show a remarkable tendency of credit-scoring practices: bleaching group identities.

The Feminist NOW movement

The goal was clear: women's status as women should be irrelevant to credit decisions. With their movement, feminists were able to place the issue of lending discrimination against women on the political agenda. NOW even succeeded in making a passage of an anti-discrimination statute. It was in 1974 that the Equal Credit Opportunity Act (ECOA) was signed into law. The implementation, however, remained a challenge (Krippner, 2017, p. 17).

In the testimony on proposed regulations for implementing ECOA, NOW wanted members of the Federal Reserve Board to drop sentences that suggested that 'ordinary credit standards' should apply equally to both men and women. In first instance, they succeeded. The testimony stated: "[...] many creditors, in hopes of making up for past discriminations, are willing to bend their ordinary standards of creditworthiness for women who are borderline applicants." (Krippner, 2017, p. 22). It was a perfect example of an affirmative action policy (Singer, 2018, p. 110). It looked like a victory. But it did not take long before other women's organizations stamped these statements (which favored women over men) as 'antifeminist'. Feeling the heat, NOW quickly recalled the testimony. In a new draft they rejected the suggestion that standards for female loan applicants should be relaxed by creditors. Instead, they added that the appropriate subject of the antidiscrimination law should be the *individual* (Krippner, 2017, p. 22). This allowed banks to use the following reasoning:

“No single characteristic will permit an approval nor cause a rejection for credit extension to the applicant. (...) No single, coherent identity characterized those denied credit, and no single, isolated characteristic could be identified as the cause for denial.” (Krippner, 2017, p. 21).

By doing this, the feminist movement shot herself in the foot. Now that the emphasis was placed on the *individual woman* instead of *women in general*, ‘the burden of history’ argument fell away. Lending inequalities amongst gender were no longer seen as a result of past discrimination against women in the labor market and the family, instead it was seen as a cumulative effect of poor choices of the individual woman herself. In this way, credit scoring practices not only individualized but also moralized making claims. The structural forces that sorted individuals in markets were obscured. This paved the way for banks to argue that they could not be held responsible for a woman’s disadvantaged position in the credit market (Krippner, 2017, pp. 22-24). Thus, credit scoring systems kept doing what they did: amplifying already existing inequalities.

As a result, traditional credit scoring indicators – such as contract duration, homeownership and income – became the determining factors once again. Tragically, these were all strongly correlated with gender and remained unadjusted to the weaker position women *as a group* had. In this way, credit scoring tarnished women’s group identity, which was the basis of collective mobilization in the first place (Krippner, 2017, pp. 21-22). Krippner summarized it quite well:

“The result of credit scoring was to first disassemble the group identities constitutive of social and political action and then recombine the resulting fragments into a lifeless statistical aggregate.” (2017, p. 21).

The NOW example illustrates a remarkable tendency of credit-scoring practices: placing too much emphasis on individual characteristics and too little on the social contexts of groups. Following its logic: it is the individual who is responsible for its own position in society, it is the individual who must prove that they are worthy of credit and it is the individual who must make political claims when treated unjustly. The last one is particularly difficult.

Alienation

This improper focus on individuality could be seen as a form of *alienation*¹¹. It is important to understand this concept. The process can be defined as ‘the problematic separation of a subject and object that properly belong together’ (Leopold, 2018). This definition consists out of three elements: a subject, an object and the relation between them.

The *subject* is a self: a person, an individual agent or a group of people. The *object* can take various forms, one can be alienated from another person, from itself, but also from a social practice or an institution. So the object might be an entity that is not a subject. The *relation* should be one of problematic separation

¹¹ Either individual characteristics are distilled from the individual and thereafter ascribed to a group – although there is no natural connection between the two – or group characteristics are distilled from the group and thereafter ascribed to individuality.

between the subject and object. We speak of problematic separation because the subject and object properly belong together. This means that the separation has to infringe the proper connectedness between the subject and the object if we want to speak of alienation (Leopold, 2018).

For the feminist movement, the subject would be *women*. The object would be their *relevant characteristics*, such as a lower income level or a shorter contract duration. In the NOW case, there was a problematic separation between *women* and their *relevant characteristics*. Those characteristics, which belonged to women's social positions, were separated from general womanhood and thereafter ascribed to individuality. This is problematic since those character traits – however tragic – belonged to them. By denying this connection, the very problem of discrimination against women could be denied. By seeing credit-scoring indicators as individual traits instead of group characteristics, it became harder and harder for women to form or maintain their group identity. This in turn complicated the ability to mobilize themselves politically.

In the next section I will provide an example that has been more successful than the feminist movement. The great difference between the two, is that the following example succeeded in making political claims on a collective basis, whereas the feminist movement stranded at the individual level.

The Community Reinvestment Movement

In the late 1960s and early 1970s the Community Reinvestment Movement (CRM) arose. They revolt against creditors who almost by definition deemed residents of urban neighborhoods unworthy of credit (Krippner, 2017, pp. 24-25). Bankers used so-called *red-lining* practices. They based the allocation of credit on social-geographical traits. Racial and ethnic homogeneity of a neighborhood, for example, was seen as a determinant of property values. This influenced the credit scores of people who lived in these neighborhoods. Naturally, red-lining became a self-fulfilling prophecy: banks denied mortgages and home improvement loans to people from these neighborhoods, which resulted in a decline of property values and a deterioration of the local community. Once minorities moved to a certain residence, the neighborhood could quickly 'flip' into a redlined area (Krippner, 2017, pp. 25-26).

The effects of these practices were most evident in urban Chicago. Many residents experienced difficulties in gaining access to credit. Mortgages and small business loans were hard to come by. Members of the community suspected banks of making deliberate decisions to withhold credit from the area. Data confirmed their suspicion: Chicago's urban neighborhoods generated 28% of bank deposits yet only received 10% of new loans. The practice, in which banks received deposits from urban neighborhood residents but provided credit in other areas, was called 'disinvestment' (Krippner, 2017, p. 35). As a reaction '*green-lining*' campaigns emerged. Initiators of these campaigns called upon urban residents to withdraw their savings from banks that were neglecting local needs and transfer them to those creditors that were willing to make loans in these areas. In the following year, three local banks agreed to commit

6,6 million dollars available for new mortgage lending (Krippner, 2017, pp. 30-33). It was a small success, but not enough.

The community activists wanted to enforce accountability of banks on stricter legal grounds. In order to do so, they turned to politics. Their political mobilization led to the introduction of the Community Reinvestment Act (CRA). The 1977 bill stated that financial institutions had “(...) an affirmative obligation to meet the credit needs of the communities in which they are chartered”. It forced financial institutions to both articulate their ‘primary savings service area’ as well as how much credit they would reinvest in that area (Krippner, 2017, p. 33). They won the battle, so it seemed.

Notwithstanding its success, for a long time it looked like the CRM awaited the same fate as the NOW campaign. In organizing their offensives, banks pointed towards the Home Mortgage Disclosure Act (HMDA). The bill stated that taking location into account in lending decisions was in many cases a legitimate business practice. Building upon this law, banks came up with an argumentation that had great resemblance with critiques on the feminist ECOA. They argued that there were *business reasons* for denying credit in black neighborhoods, so they had ‘a right to exclude’. In addition, banks stressed that they were businesses, not welfare organizations.

“Unfortunately, there is a relationship between high unemployment, less stability and income, and minority areas,” one savings and loan president observed. “But [savings and loans] didn’t create that [situation].” (Krippner, 2017, p. 34).

Where the feminist movement stranded at the conclusion that banks could not be held responsible for women’s disadvantaged position in credit markets, the community activists were more successful. They challenged the creditor’s right to exclude potential borrowers. They did so by focusing on ‘disinvestment’. By investigating this practice, the community activists could parry a stubborn argument. Banks claimed that only those individuals who were not creditworthy were denied credit. But this turned out to be false. In fact, people were not excluded on the basis of creditworthiness but on the basis of disinvestment: resources that *belonged* to neighborhood residents were being extracted from the community and transferred into other areas¹² (Krippner, 2017, pp. 34-35). Banks were unable to deny this.

By arguing in terms of ownership, the community activists made a successful claim on having access to credit. Their claims had the capacity to undermine the inherent inequality between banks and costumers. Instead of being subject to critical examination of creditors, community activists asserted ownership over bank deposits. By doing so, they flattened the hierarchy between the creditor and borrower in favor of the latter. It gained strength because it was enforced *collectively*. It was a manifestation of economic citizenship. As Krippner concluded:

¹² Some banks use savings as a form of equity, which is needed to create new credit (WRR, 2019, p. 40).

“[...] individuals who claimed a right to credit did so not on the basis of their individual ownership of financial assets, but by virtue of their relationship to a community of individuals who were in the aggregate property owners.” (2017, p. 36).

2.2.4 Political erosion

Both examples illustrate the tendency of credit-scoring practices to base exclusion from credit on individual traits, while in fact they are correlated with social contexts. As the CRM almost was victim of the same reasoning held against NOW, it became clear where the differences between the two campaigns lay.

In the feminist case, banks were able to deny their responsibility for women’s weaker position in society. By holding the *individual* personally responsible for one’s own creditworthiness, it became harder and harder for women to mobilize themselves as well as to make political claims in the credit market. As a consequence, structural injustice could prevail. The community activists, however, showed the flipside of the coin. Unlike the feminists, they were able to sidestep the argumentation of bankers. Residents were not denied credit because of their individual creditworthiness, they argued, but because they carried a group characteristic: being a resident of a red-lined neighborhood. It was because of their *shared identity* and *collective mobilization* that community activists could enforce their political demands. Up to the present day, the reinvestment movement has remained viable.

Nowadays, those aspects that proved to be vital for making political claims are under pressure. Due to more fine-grained forms of credit scoring it becomes increasingly difficult for borrowers to form group identities and to mobilize themselves. Algorithmic decision making in credit scoring provides an excellent example of this worrying practice. On the one hand these algorithms handle a greater number of people, while at the same time having a narrower focus on individual traits. As a consequence, the social contexts in which these traits arise become more difficult trace back.

“The rising importance of credit and debt has evolved along with a growing moralization of accountability and individualization of responsibility that imposes responsibilities for financial difficulties on individuals more than institutions. Public understandings of class inequality become personalized and individualized, masking the role of elites and institutions in perpetuating unfair arrangements (Hacker 2006, William 2004, cited in Dwyer, 2018, p. 255).

Currently, credit is no longer denied to people from a certain place or class, but it is denied to individuals “whose identities had been sliced and diced into smaller and smaller pieces” (Krippner, 2017, p. 20). People from a wide range of different places, who have hardly ever been in contact with each other, are merged into groups based on their similar degree of creditworthiness. These are groups of which people experience no membership, even though this membership has a great influence on their life-chances

(Krippner, 2017, p. 21). That is problematic. The feminist example showed what happens if group forming is hindered, whereas the example of urban Chicago showed what could be accomplished if collective mobilization is encouraged. Nowadays the ability to mobilize collectively against injustice in the credit-sphere is threatened. In the following section I will focus on the new ways of estimating credit scoring that cause this threat. In doing so, I will illustrate how they can lead to forms of statistical discrimination and alienation.

“While the moralization of the creditor-debtor relation is an old story, what is new and deserves attention here are the techniques through which this moralization operates” (Krippner, 2017, p. 10).

2.2.5 Statistical discrimination

In distributing credit algorithms play an increasingly important role. They often make pre-selections in who is eligible for credit and they also help banks in targeting new potential borrowers. If we want to understand banking from an ethical point of view, it is not only necessary to evaluate algorithms on their technical performance, but also on their re-distributive effects. Therefore, we need both a social and technical understanding of algorithms in credit scoring¹³.

Using algorithms for credit scoring, people can get excluded from having access to credit because they carry certain characteristics or proxies of the context they live in¹⁴. For some of these characteristics, individuals can be held responsible, such as criminal behavior. Exclusion on these grounds thus seems acceptable. But there are cases in which exclusion from credit is less legitimate.

Banks can engage in discriminatory practices due to algorithmic decision making. In common usage, the term discrimination refers to the exclusion of individuals from access to something on the basis of membership in a social category. But banks would frame it differently. For them discriminatory practices are driven by concerns of efficiency. It refers to the act of exercising judgments: the process of sifting out the good from the bad credit risks (Krippner, 2017, p. 19). As explained earlier, banks engage in these practices by estimating creditworthiness. In doing so, banks use certain characteristics as statistical proxies that indicate the probability of repayment. In doing this, banks can be accused of engaging in *statistical discrimination*. In the following section I will explain how banks engage in these practices and what is morally objectionable about it.

2.2.5.1 Social salience

There are several forms of statistical discrimination. It can take place against, in favor of, and between (groups of) individuals. When a group is subject to statistical discrimination, it is either socially salient or socially non-salient. A group is *socially salient* (notable) when its perceived membership is important to the structure of social interactions across a wide range of social contexts. Membership based on an

¹³ The latter has eye for technical nuances but is blind for conceptual differences of discrimination, the former has eye for the social nuances but is blind for how different types of algorithmic discrimination arises (Goodman, 2016).

¹⁴ This is not to say that algorithms understand these contexts.

individual's gender, race, age, income or religion are typically characteristics that influence such social interactions. It is often these groups that have a high degree of social salience who experience statistical discrimination.

When speaking of statistical discrimination, I share Kasper Lippert-Rasmussen's focus on '*policies of statistical discrimination against socially salient groups*' (2007, pp. 386-387). I do so because estimating creditworthiness could typically be seen as a policy, especially since it is being done on larger scales for larger groups of people in the recent decades (Krippner, 2017, pp. 18-19).

In general, 'statistical discrimination' can be described as the less favorable treatment of a certain group, based on arbitrary characteristics of these groups, which otherwise would be indistinguishable from relevant socio-economic characteristics (Goodman, 2016, p. 2). This conception holds that statistical discrimination is morally objectionable when it does not allow relevant but arbitrary characteristics to prevail, whatever these may be. A more precise and technical description of statistical discrimination is given by Lippert-Rasmussen:

A policy, P, constitutes statistical discrimination against a certain socially salient group of people, X-people, in relation to non-X-people (or some subgroup thereof) if, and only if, (i) there is statistical evidence which suggests that X-people differ from non-X-people in dimension, D, (ii) P involves treating X-people worse than non-X-people, and (iii) P is in place because of (i). (Lippert-Rasmussen, 2007, p. 387).

This definition needs to be read once or twice in order to comprehend. It may help to illustrate it with an example. When we apply this definition to the case of estimating creditworthiness for a particular group - such as *women* - it becomes clear what is morally objectionable about statistical discrimination. In the definition above we could replace 'P, X-people, non-X-people and D' respectively with 'Credit scoring practices, Women, Men and Income', assuming that women have a lower average income than men. This will result in the following description:

Credit scoring practices constitute statistical discrimination against a certain socially salient group of *women*, in relation to a group of *men* if, and only if, (i) there is statistical evidence which suggests that *women* differ from *men* in dimension of *income*, (ii) *credit scoring practices* involve treating *women* worse than *men*, and (iii) *credit scoring practices* are in place because of (i).

It should be clear that when women are denied access to credit, or only get access against higher interest rates due to their relatively lower average income, that we can speak of morally objectionable statistical discrimination. In this case, statistical discrimination further deteriorates the economic position of women. However, a banker could say that an individual woman is not excluded from credit because of her gender, but because she carries relevant proxies (a lower income) that indicate a low probability of repayment. As

a consequence, exclusion from credit is not a result of discrimination, but of efficiency. The same could be said when we replace ‘X-people’ for people with a black skin-color. In that scenario, a person with black skin is not excluded from having access to credit for being black, but for having characteristics that indicate a higher credit risk. That these characteristics are correlated with skin-color, could be perceived as rather a coincidence than a causality¹⁵. However, one could also see this correlation – or even the causality, if any – as *socially constructed* instead¹⁶.

2.2.5.2 What is wrong with statistical discrimination

When analyzing algorithms in banking, we can distinguish four kinds of statistical discrimination that are morally objectionable. First of all, statistical discrimination can be morally objectionable when it is based on prejudiced or arbitrary ‘social facts’ (Lippert-Rasmussen, 2007, p. 386). The construction of these ‘social facts’ can be a result of self-fulfilling expectations: statistical discrimination can create the very same statistical facts that are then appealed to in order to justify that practice (Lippert-Rasmussen, 2007, p. 403). For example: denying poor people access to business credit or charging them with higher interest rates due to their lower probability of paying it back, makes it even harder for these poor people to start a profitable business, and as a consequence, further deteriorates their chance of repayment.

Secondly, statistical discrimination in estimating creditworthiness can be morally objectionable because of its risk-averse character. Credit scoring algorithms prefer to grant access to those for whom its predictions are more accurate. This means that when banks lack information about new loan applicants, that the uncertainty of the algorithmic predictions will increase, which in turn will result in stamping these people as less creditworthy. Historically under-represented groups will therefore remain under-represented (Goodman, 2016, p. 5).

Third, statistical discrimination can be morally objectionable when it treats similar cases differently. Imagine there are two groups (group A and group B). Within each group you can find a similar person with the same creditworthiness estimate (Sophie A and Sophie B). Despite their similarity, both Sophies can be treated differently. This has to do with the general characteristics of both groups. Sophie A can receive a lower credit-score than Sophie B because group A exists out of people who on average have a lower income. Therefore, the algorithm will treat Sophie A as having a lower ‘risk-adjusted credit-score’. Put differently, the average interval of defaulting for each individual in group A is longer than group B. Sophie A has a longer ‘error bar’ and therefore will receive a higher ‘uncertainty penalty’ resulting in a lower credit-score, as is shown in figure 4 (Goodman, 2016, pp. 5-6).

¹⁵ It was this very reasoning that banks used against the NOW and the CRM campaigns.

¹⁶ To what extent statistical discrimination in banking is a product of economic inequality or stood at its cradle, remains an important question. However it may be, I want to avoid this chicken or egg discussion. The only thing I want to emphasize here, is that statistical discrimination in distributing access to credit magnifies already existing inequalities, wherever these may come from. It is because of this magnifying effect that statistical discrimination in banking deserves attention.

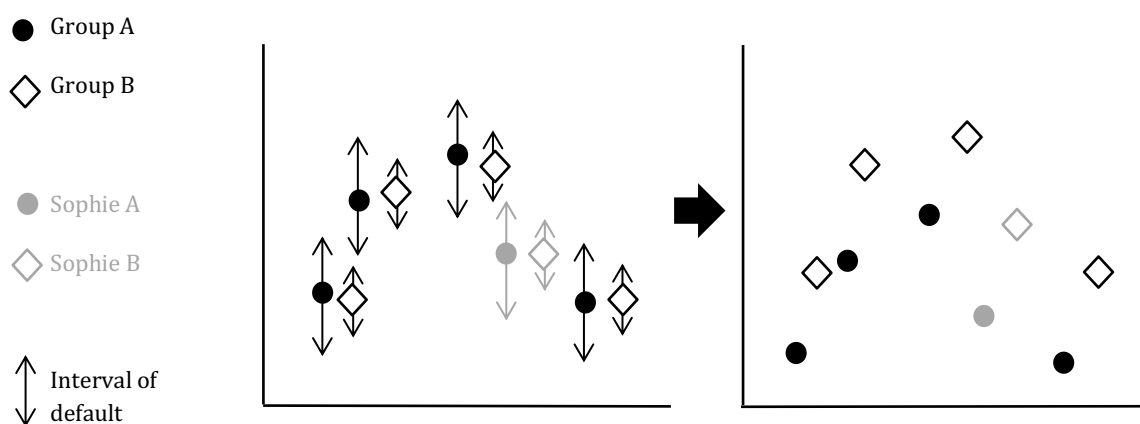


Figure 4. Abstract representation of risk adjusted predictions of repayments (Goodman, 2016, p. 5).

Uncertainty penalties can have even bigger consequences on credit-scores when algorithms are supplemented with decision boundaries: a threshold of creditworthiness. Even if Sophie A and Sophie B are both part of the same normal distribution, have the same initial credit scores and as a consequence both fall above the threshold; they can be treated differently. When the score of Sophie A is adjusted to prediction certainty, she will nonetheless fall below the threshold (see figure 5).

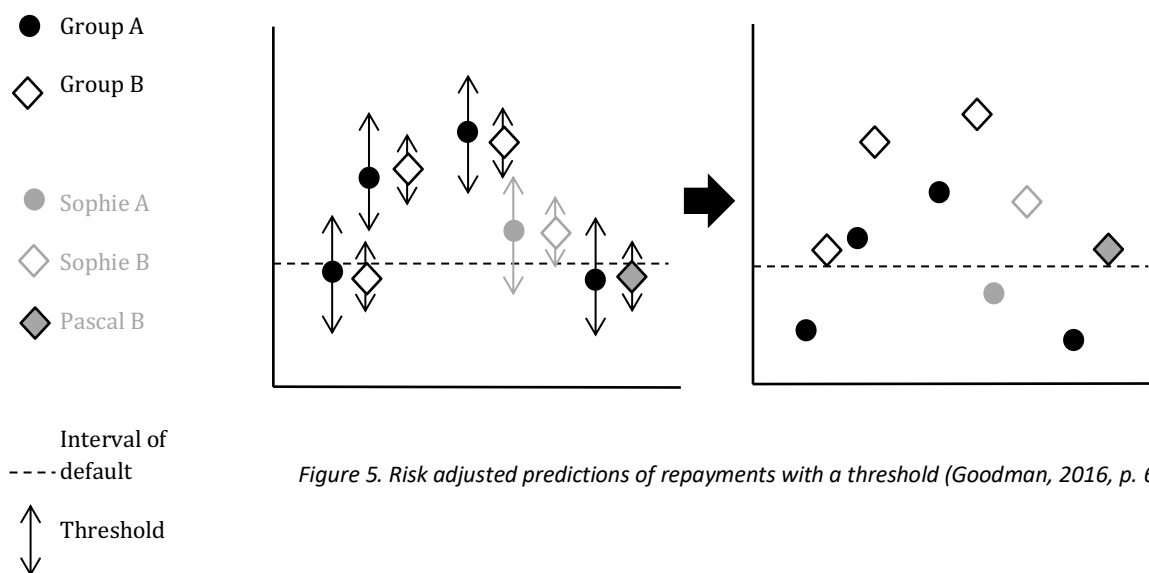


Figure 5. Risk adjusted predictions of repayments with a threshold (Goodman, 2016, p. 6).

Ironically, Sophie A can have a higher initial credit score than other people from group B, like Pascal B, but a lower adjusted credit score than him. As a consequence, Pascal B will fall above the threshold while Sophie A falls below it (see figure 5). She is penalized for being part of the group that has less available information. In this scenario, there is a so-called ‘discriminatory uncertainty bias’ to an initial neutral

algorithm (Goodman, 2016, p. 6). It is because of groups characteristics that Sophie A is statistically discriminated and therefore receives a lower credit score.

Fourth, if less represented groups of loan applicants in normal distributions are difficult to predict, statistical discrimination can occur. Because of their low predictability these groups are less likely to be trusted. A common response from banks is to assign individuals from these groups a credit score that is closer to the ‘hypothesized mean’ of the group. By doing so, banks can be accused of relying too much on stereotypes. When these stereotypes are incorrect, we can speak of statistical discrimination. As a consequence, underrepresented groups will be penalized in their scores, especially since most algorithms have uncertainty bias and risk aversion formulas in their design (Goodman, 2016, p. 6).

Summary

All kinds of statistical discrimination mentioned above can lead to the exclusion of minorities: groups who typically have a high degree of social salience. In such cases, the social salience of the group instead of individual properties is the reason for excluding minorities (Lippert-Rasmussen, 2007, p. 395; 403). When marginalized or impoverished minorities are subject of statistical discrimination, two things can be the case. It either signals that people in society do not relate to each other as equals, or it casually contributes to ensure that people in society do not, or will not relate to each other as equals (Lippert-Rasmussen, 2007, p. 387; 393). As a consequence, structural injustices towards these groups prevail (Herzog, 2017, p. 415). It unfairly treats individuals on the basis of group averages or perceived social traits both of which they carry no complete personal responsibility.

Statistical discrimination in distributing credit by banks can be morally objectionable for three reasons. It is objectionable (i) if it builds upon ‘social facts’ without having eye for the possibility that these are rather socially constructed than factual, (ii) if it gives uncertainty penalties to one of two similar cases in a normal distribution and (iii) if it treats individuals on group averages when it is missing information.

What all these kinds of statistical discrimination have in common is their lack of understanding social contexts. Such epistemic failures are easy to spot: tendencies to *stereotype* reflects a lacking sense of social nuance, reliance on supposed *social facts* reflects poor social investigation and *uncertainty bias* would not even exist without a poor knowledge of social contexts.

In order to overcome this myopia for social contexts, bankers should use different methods for gathering additional information. Perhaps inspiration can be found in old fashioned ways of banking, by additionally applying ‘connection-strategies’ for example (Krippner, 2017, pp. 8-9). Nowadays, however, the lack of social understanding is deteriorated even more.

2.2.5.4 Big data

To overcome uncertainty bias and lack of information, banks seek salvation in the usage of Big data and ‘digital footprints’ (Berg, Burg, Gombovi, & Puri, 2018, pp. 2-3). In doing this, banks combine data from

different sources. Behavior on social media, the visiting of websites and clickstreams provide them with valuable information. For instance, someone's relationship-status on Facebook is correlated with someone's likeliness to default. Those who notify that they are married are often lower educated and less likely to repay their debts than those who keep their relation status secret. A similar correlation applies to the type of mobile phone people use. Those who have an iPhone are more likely to repay their debts than those who have another brand of phone (Kitchin, 2014, p. 17). The information provided by digital footprints turned out to rather complement than replace traditional credit scoring (Berg, Burg, Gombovi, & Puri, 2018, p. 5).

The effects of using Big data and digital footprints are twofold. On the one hand, costumers who otherwise would be excluded from credit can now receive loans. This is because digital footprints facilitate access to 'unscorable costumers': costumers without existing credit-scores. Such a practice has the potential to increase financial inclusion and lower inequality (Berg, Burg, Gombovi, & Puri, 2018, pp. 6, 28) On the other hand, Big data usage in credit scoring can also have a reinforcing effect. Due to its tendency to limit risk and increase certainty, it can further exclude the worse-off and further include the well off. Algorithms compare the information provided by digital footprints to already existing credit scores. By doing this, to some extent, it builds upon already existing socio-economic differences. Furthermore, the types of online behavior that are considered to be tasteful or dominant are correlated with the well-off. Consequently, they are rated higher by the algorithms. By doing so, it overlooks that the valuation of this behavior is culturally determined. Understanding the nuances of social contexts in which behavior originates, is not something we can reasonably expect from algorithms using Big data (Berg, Burg, Gombovi, & Puri, 2018, p. 5). Therefore, bankers should rely on so-called "Thick Data" techniques as well. In addition to quantitative information, they should also focus on qualitative information (Wang, 2016). Bankers should develop a better understanding of the social contexts people live in. At least, if we want banking to be just.

2.2.6 The Schumpeter's dilemma

I argue that bankers should invest more time in trying to understand people's social contexts. This could increase the inclusion of the less fortunate into the credit market under proper conditions. Or at least, decrease the likeliness of wrongful exclusion (as illustrated in the previous sections). This way, bankers could give a more justice-sensitive interpretation to their moral authority. But doing so confronts them with a dilemma.

On the one hand, bankers could include the less fortunate into the credit market. It would provide these people with an important source of income, which is necessary for participation in society. If this access is granted under proper conditions, it could decrease economic inequality. Interest rates would no longer work as a catalyst for economic differences among people. Instead, it would enable a more egalitarian starting position. In doing so, bankers interpret their moral authority in a way that fits the public role of banks.

On the other hand, if bankers would include too many poor people, then the stability of the credit system would be endangered. Granting credit to people who have no stable income, job or collateral would affect the general trust people have in the functioning of the economy. Including too many poor people into the credit market, especially if they be charged with too high interest rates, could lead to a repeat of the credit-crisis (Streeck, 2015, p. 35). Instead of creating debts that are impossible to repay bankers could also focus on those who are more creditworthy. Since granting loans to them would not affect the general trust. Moreover, it would provide banks a decent revenue model. In doing so, bankers would interpret their moral authority in a way that fits the private role of banks.

This dilemma is also articulated – though slightly differently – by Joseph Schumpeter (1939). He made a distinction between two kinds of bankers. This distinction clarifies the nature of the dilemma bankers face. On the one hand there are “prudent bankers”. These bankers follow ‘sound banking traditions’: gate-keeping strategies that attract those who are creditworthy and hold off those who are not (Polillo, 2011, p. 444); (Herzog, 2017, p. 429). Banking traditions like this typically create exclusions and opportunities for conflict, as the NOW and CRM cases illustrated. While it can lead to economic stability in the short run, it could also cause increasing inequality. In the long run, the economy will therefore deteriorate¹⁷.

On the other hand there are bankers who disobey sound banking traditions. They create more inclusive but more unstable credit systems. I will call these “bold bankers”. Typical examples are the American ‘wildcats’¹⁸ from the nineteenth century, the ‘loansharks’¹⁹ from the great depression and the ‘payday lenders’²⁰ of the last credit crunch. The wildcats and loansharks often operated outside the law whereas payday lenders are strictly spoken legal (Lastra & Brener, 2017, p. 43). What all these examples have in common, is that they offered loans to those in need – often called ‘fallen angels’²¹ – at high or extremely high interest rates. By doing this, bold bankers could include poorer segments into the credit market. This often came at the price of increasing instability, since it was not very likely that poor people could repay large debts. As a consequence, the trust in the credit system, and therefore its functioning would often be affected (Polillo, 2011, pp. 444-445).

The archetypal distinction between the prudent- and the bold banker tells us something about the moral authority of their profession. It tells us that bankers’ ability to create and allocate credit is grounded on their ability to draw *boundaries* between people. Thus, the question is: how to draw these boundaries?

¹⁷ See for example Bas van Bavel (2016). *The Invisible Hand? How Market Economies Have Emerged and Declined Since AD 500*. Oxford, United Kingdom: Oxford University Press. Or Thomas Piketty: Broers, V. (2014). Wat Piketty zegt. In V. Broers, Thomas Piketty's Kapitaal Samengevat In Nederlands Perspectief (pp. 13-53). Amsterdam: Prometheus Bert Bakker

¹⁸ Wildcat banking refers to the banking industry in the United States from 1837 to 1865. In this period of time, some banks were located in remote and inaccessible parts of the country. These banks did not have any federal oversight, which enabled them to issue their own currencies and also to define their own terms of creditworthiness (Kagan, Wildcat Banking, 2018).

¹⁹ ‘Loanshark’ is the term for a person or entity that charges borrowers with interest above an established legal rate. They often operate in underbanked areas. In cases in which people could not repay their debts, loansharks let these people perform shadowy practices in the illegal spheres (Kagan, 2019).

²⁰ The term for short-term lenders who extend high interests on immediate credit, based on a borrower’s income and credit profile. Typically, payday lenders charge a portion of a borrower’s next paycheck (Kagan, 2019).

²¹ The term for those who fell below thresholds of creditworthiness and investment grades.

Whom to include or exclude from access to credit? From a justice point of view, this question would result in the following moral challenge: how to include ‘fallen angels’ into the credit system without making them subjective to ‘bold bankers’ and without making the credit system instable? (Polillo, 2011, p. 445). I will call this the *Schumpeter’s dilemma*. It was Dwyer who captured something similar:

“A major challenge is balancing inclusion and exclusion in policy designs so that disadvantaged groups maintain access to good credit as needed but still get protection from the worst abuses.” (Dwyer, 2018, p. 255).

The Schumpeter’s dilemma could be seen as a collective action problem as defined by Joseph Heath (2006): “interactions with an outcome that is worse for everyone involved than some other possible outcome.” (2006, p. 313). Let me illustrate this.

If most bankers would act like a bold banker, then the stability of the credit system would deteriorate, making everyone involved worse off – as was shown during the crisis. Also, those banks who would include too many ‘fallen angels’ would have a competitive disadvantage compared to banks who do not. But if most bankers would act like a prudent banker, then the economic inequality would increase, making everyone involved worse off in the long run in terms of distributive justice but also in terms of economic stability (Treeck, 2014, pp. 421; 441-442); (Malinen, 2016, p. 323). By excluding the lower and middle class from credit, economic activity among these people would deteriorate – as we saw during the aftermath of the last crisis and the following recession (Ouden, 2018, p. 1573).

Thus, if we want a better possible outcome of this collective action problem, we should accept some form of constraints over bankers professional conduct. Such constraints can typically be provided through the organization of social institutions (Heath, 2006, pp. 313-315). In the next chapter I will discuss different possibilities for such social institutions.

2.3 Conclusion

In the second chapter of this thesis I dove into ethical aspects of banking. I began with arguing that access to credit is a matter of justice. I argued that it is increasingly necessary to obtain credit in order for people to fully participate in society. Therefore, access to credit could be seen as a *currency of distributive justice*.

I continued with the claim that bankers have a *moral authority*. This is because they make judgement of people in terms of creditworthiness, which has a major impact on someone's life. I showed that this role is fulfilled using gate-keeper strategies, which not only reinforces socio-economic differences but is also self-reinforcing. Making it unlikely for current ways of banking to change any time soon.

Thereafter, I distinguished several ethical issues, beginning with the *increasing inequality* our current credit system creates. Through charging the weakest shoulders the largest interests, the current way of allocating credit is opposed to the difference principle: the worst-off are the least provided. I rejected the counter argument of 'free choice' by arguing it poses a false dilemma. It has an illegitimate focus on individual responsibility. Instead, I argued that we should focus on the social positions of individuals within social groups, in order to understand the inequalities created by credit. By doing so, I showed that already existing inequalities are often reinforced through banking, making it a mechanism of *structural injustice*.

Next, I stressed the importance of political mobilization against these injustices and how it is hindered by alienating forces. I explained that the improper focus on individuality in credit scoring could be seen as a form of *alienation*. It leads to a problematic separation of a subject and object that properly belong together. By seeing credit-scoring indicators as individual traits instead of group characteristics, it becomes harder for people to form or maintain their *group identity*. This in turn complicates the ability of *political mobilization*. I argued, in addition, that these two vital aspects for political claim making are under pressure. I did so by pointing towards new ways of credit scoring. Through the usage of algorithms, Big data and digital footprints banks merged people with a similar credit score into groups from which they experience no membership. This hinders their ability to make political demands.

Furthermore, I showed that different kinds of statistical discrimination commonly lack the ability to understand *social contexts* of people. Therefore, bankers should invest more time in trying to understand these social contexts, so that the inclusion of the less fortunate into the credit market could be increased. In this way, bankers could give a more justice-sensitive interpretation to their moral authority. In trying to do so, however, bankers face a moral dilemma. A dilemma between their public and private role and between justice and stability. I called this the *Schumpeter's Dilemma*. Including too many poor people into the credit market would endanger the stability of the credit system. But excluding too many unfortunate people from credit would deteriorate equality and the functioning of the economy in the long run. Thus, I concluded that bankers face a collective action problem, which should be tackled through organization of social institutions. In the next chapter, I will argue why an Elected Banker is a possible solution.

3. The Elected Banker

In this chapter I will argue why bankers should be democratically elected. In order to do so, I build upon the conception of democratic equality. Next, I will show how the institution of an Elected Banker would look like and how it could solve the problems mentioned in the previous chapter. Although there are many other possible solutions for the current injustices imposed by banking – such as more regulation on credit access (Dwyer, 2018, p. 255) a state guarantee on creditworthiness (Meyer, 2018, p. 321), introducing a public money system (WRR, 2019, pp. 192-195) or proposals for making access to credit a right (Hudon, 2009); solutions to which I gladly refer – I prefer to dive into this particular idea. I do this, not so much because I believe an Elected Banker is necessarily the best solution, but rather because it opposes the current way of banking. I believe it challenges bankers' view of what their profession is about. In order to make moral progress in the banking sector, bankers must become aware of the moral authority they possess, as well as how they currently fulfill this role. An effective way to do this is by inviting them to the thought experiment of the Elected Banker. In order to do this, I will begin by clarifying the framework on which it is build.

3.1 Democratic equality

In order to challenge the current logic of banking, I introduce the egalitarian view of 'democratic equality'. In *What is the point of Equality?* Elizabeth Anderson referred to inequality not so much in terms of the distribution of goods, but rather in terms of social relations between superior and inferior persons (Anderson, 1999, p. 312). One could argue that such a hierarchal relation is created through the creation of credit: the creditor is often in a better position than the debtor, especially when the debtor belongs to the poorer segments of society. The democratic equality conception, however, opposes such hierarchies by stressing the equal moral worth of each person. From this point of universal moral equality, democratic egalitarians derive their claims on social and political equality. They seek to live together in a democratic community. That means that they want to realize a collective self-determination through open discussion among equals in accordance with unanimous accepted rules (Anderson, 1999, p. 313). In order to create such a society, Anderson stated:

To stand as an equal before others in discussion means that one is entitled to participate, that others recognize an obligation to listen respectfully and respond to one's arguments, that no one need bow and scrape before others or represent themselves as inferior to others as a condition of having their claim heard. (Anderson, 1999, p. 313)

The institution of an Elected Banker could typically provide the above mentioned democratic egalitarian requirements. By giving debtors a stronger voice in their currently unequal relationship towards creditors,

the realization of democratic equality can be strengthened. A better position of the debtor demands respect from bankers, making it possible for the former to make political claims when they believe this is necessary.

Anderson distinguished several desiderata for egalitarian principles. The first is that such principles must identify *goods* to which all citizens must have access to over the course of their lifetimes (Anderson, 1999, p. 314). In the previous chapter I underlined the importance of having access to credit, one would therefore think I want to identify credit as such a good. While others would²², I want to argue that is difficult to designate credit *per se* as an egalitarian good. Especially since access to credit for all, including to the not-creditworthy threatens financial stability. Instead, I identify *the influence on the creation and allocation process of credit* as an egalitarian good to which all citizens must have effective access. This way, borrowers can exercise their democratic rights and moral responsibilities (Anderson, 1999, pp. 312-314). It entitles them to the capabilities that are necessary to function as an equal citizen in a democratic state. The possibility to make political claims in the credit sphere would typically be such a capability (Anderson, 1999, p. 316). The realization of this egalitarian good can be achieved by implementing the institution of an Elected banker. In the following section I will give an overview of my proposal.

3.2 The proposal of an Elected Banker

In this chapter, I will not primarily focus on what the institution of an Elected Banker will look like. Instead I will focus on the question *why* bankers should be elected in the first place. By giving several reasons in favor of an Elected Banker, the groundwork is laid for further philosophical development of this idea. I am aware that the implementation of this institution raises many questions. Needless to say, future research is needed in order to both articulate and answer these questions. However, it is beyond the scope of this thesis to formulate them in detail. Therefore, I will sketch a rough outline of what the institution of an Elected Banker could look like.

Type of banker

First, we should discuss what type of banker should be electable. This could differ from the local banker to the head of the bank. In the ideal situation the Elected Banker would be responsible for the functioning and behavior of the bank – just as our political representatives are responsible for the functioning and behavior of our bureaucracy. Therefore, it would seem logic that bankers in the managerial level should be subject of election by everyone who holds a bank account. The minimal requirement for a banker to be elected, is that they have influence on the formulation of terms of creditworthiness. Consequently, this would include having a say in the design of algorithmic preselections as well as in the distribution of interest rates.

²² Such as Hudon (2009) or Meyer (2018).

Indirect election

Bankers should be elected based on both their political color as well as on their expertise. If we would solely focus on political popularity, the economy could worsen. 'Free credit for everyone' could be an attractive yet not very realistic political slogan. But on the other side, if we would solely focus on financial expertise, the moral component of credit creation could receive too little attention. In order to overcome this dilemma, there must be an indirect election of bankers. In this scenario, the debtor would choose a delegate based on political color who in turn would choose bankers based on expertise. This way, the election process will attend to both the political as well as the technical aspects. Furthermore, bankers should be elected for a fixed period of time. This would stimulate bankers to serve their customers in their political demands. If they fail to do this, they would ideally not be re-elected.

Party system

Bankers could be elected through a party system. These parties would put forward delegates who in turn would elect bankers. This institution could either build upon an already existing political party system or could be organized through a new party system which is focused on the credit market.

3.3 Why bankers should be elected

Several problems of the current way of banking that have been identified in the previous chapter can be solved through the social institution of an elected banker. Bankers should be elected for several reasons. First of all, bankers should be elected because they create and distribute credit. This 'currency of distributive justice' could be seen as a primary good in the Rawlsian sense since people are increasingly dependent on credit as a source of income (Herzog, 2017, p. 415).

Due to the nature of credit, borrowers should have a democratic voice in the creation and allocation of credit. Especially because borrowers play a vital role in this process: without people applying for a loan, credit cannot be created. In order for bankers to create credit, and as consequence make a profit, they *need* borrowers (WRR, 2019, p. 40). Vice versa, borrowers need bankers as well, since bankers have the privilege to create and allocate money. One could therefore argue that there is a *mutual dependency* when it comes to credit (Meyer, 2018, p. 319). Because of this mutual dependency, both parties should have influence on the practice of credit creation and allocation.

In addition, one could argue that there is a form of *shared ownership* when it comes to credit (Krippner, 2017, p. 36). This shared ownership is reflected in the dynamic of 'mutual debt acceptance'. On the one hand banks have a liability towards costumers to provide exchangeable credit while on the other hand costumers owe the bank debt including interest. Especially because the debtor has a weaker position than the creditor in this dynamic - since the debtor experience stricter conditions in repaying debt than the creditor has in providing credit - they should be able to make political demands (WRR, 2019, p. 43).

Unlike the wage relation, which depends on the formal equality of parties to exchange, the extension of credit constitutes an unequal relationship between creditor and debtor during the period of time in which the debt remains unpaid (Krippner, 2017, p. 3).

By electing bankers, borrowers can exert influence on the credit creation and allocation process by holding bankers politically accountable for the injustices they may create. For those who think that mechanisms of increasing inequality and structural injustices imposed by banking are undesirable, the Elected Banker could be an outcome to oppose these practices. At the same time, those who think this is no problem at all, may just as well organize their democratic resistance through the election proposal.

Second of all, bankers should be elected because the privilege to create and allocate credit gives them a *moral authority*. Along with this authority comes great responsibility. The ability to choose whom to include into the credit market and the power to dictate the conditions for inclusion, are of impact on human lives and on society as a whole.

This responsibility should be taken seriously by bankers. They should be held politically accountable for their choices. This can be achieved through the process of democratic election. Nowadays, many bankers are not aware of their moral authority, nor do many of them have the qualities necessary to exercise this authority:

(...) to be a banker, it takes “not only highly skilled work, proficiency in which cannot be acquired in any school except that of experience, but also work which requires intellectual and moral qualities not present in all people who take to the banking profession.” (Polillo, 2011, p. 444).

Currently, banks are primarily held accountable by their shareholders. But there is a great difference between having a voice through shareholding and democracy. In the former, those who have the greatest share have the largest say. In the latter, the value of votes is equal (Rodrigues, 2006, p. 1389). Where shareholder wealth maximization purposes primarily serve the private role of banks, democratic influence additionally serves their public role. Such an influence is needed, since the current fulfillment of the moral authority through gate-keeper strategies has a self-reinforcing effect. It strengthens its private role and underexposes their public role. The proposal of an Elected Banker could emphasize the latter.

In the previous chapter I have illustrated the importance of political mobilization in the credit sphere and how it is hindered by alienating processes. Third of all, I would like to emphasize that these issues can be tackled through the democratic process of electing bankers. First and foremost because the Elected Banker proposal would *facilitate political mobilization* instead of eroding it. It would not only ensure the possibility for people to make political demands on a collective basis, but it could also enable them to form *group identities* in the credit market. Instead of being part of a feminist movement or being a resident of a redlined neighborhood or being part of a compound group of strangers from which you experience no membership; people can now be part of an institutionalized political party. Membership of such a party

provides an identity to people of a shared group. This could foster the ability to make political demands on a collective basis in the credit market.

Fourthly, bankers should be democratically elected because it could help them to reconnect with their customers. In the previous chapter I explained that the connection between bankers and costumers is weakened by algorithmic decision making. I also argued that new ways of banking lack the ability to understand people's social contexts and that old ways of banking, such as 'connections strategies', could inspire them to redevelop this social sensitivity. By making bankers electable, the connection between the costumer and the banker can be revitalized. In order for a banker to be elected, he needs to collect votes. In order to collect votes, he needs to know what people care about when it comes to banking. He needs to know what kind of problems people face in obtaining credit. In this way, bankers need to connect with their costumer once again, since they are dependent on them to be (re-)elected.

Finally, the proposal of an Elected Banker would provide an answer to the *Schumpeter's Dilemma*. This dilemma between stability and justice and between the public and private role of bankers, can be tackled through indirect elections of bankers. The ideal situation would be a two-staged voting system. The popular vote would elect delegates of parties based on their political belief. These delegates would become part of an electoral college, which in turn would elect a banker based on his economic expertise. Once elected, it is the challenge for the banker to find balance between its public and private role. Additionally, it is the moral obligation of the borrower to articulate dissatisfaction when the banker fails to do so.

3.3 Conclusion

In this chapter I illustrated the proposal for an Elected Banker. This idea builds upon the egalitarian conception of ‘democratic equality’, which opposes hierarchies – such as the creditor-debtor relation – by underlining the universal equal moral worth of persons. I identified *influence on the creation and allocation of credit* as an egalitarian ‘good’ to which all citizens must have effective access. I did so because this good entitles them to the capabilities that are necessary to function as an equal citizen in a democratic state. I showed how an Elected Banker would meet the requirements of democratic equality.

Secondly, I gave a rough sketch of how the institution of the Elected Banker would look like. I pointed towards bankers at the managerial level to be subject of election, since they typically have influence on formulation of terms of creditworthiness. I argued that this banker should be elected indirectly through a party system. Delegates would ideally be elected on their political color, and the electoral college of delegates would in turn ideally choose bankers on their economic expertise. In this way the dilemma between distributive justice and economic stability could be addressed. Furthermore, I argued that bankers should be elected for a fixed period of time in order to ensure borrowers can make effective political demands.

Next, I gave several reasons why bankers should be elected. The first reason for bankers to be elected is because they have a privilege to create and allocate credit. I illustrated that the *mutual dependency* between bankers and borrowers to create credit as well as the *shared ownership* of credit through the ‘mutual debt acceptance’, should entitle them both with influence on this process. The second reason why bankers should be elected is because they have a *moral authority*. Along with this authority comes social responsibility for which they should be held politically accountable. For those who think that mechanisms of increasing inequality and structural injustices imposed by banking are undesirable, the Elected Banker could be an outcome to oppose to these practices. A third reason why we should elect bankers is because the proposal has the potential to *facilitate political mobilization* in the credit market. This potential could oppose the alienating forces of credit scoring practices. Fourth, bankers should be elected because it could *revitalize the connection* with their customers, especially since bankers would be dependable on customers to be (re-)elected. Finally, the proposal for an indirectly, two-staged Elected Banker could provide an answer to the *Schumpeter’s dilemma*, since the election is based on both moral considerations as on economic expertise.

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