Money and Morality: The Christian Moral Tradition and the Best Monetary Regime

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The economic difficulties of the past several years in the United States have led more and more people to take an active interest in monetary policy and in the Federal Reserve System. Many possess an inchoate sense that there must be a connection between past monetary policy and our current doldrums. At a time when monetary matters are attracting so much attention, therefore, it may be particularly opportune to consider the moral dimensions of the present monetary regime. As we shall see, current monetary policy leaves much to be desired when evaluated against the Christian moral tradition and the thought of several Christian historical figures. To state it more bluntly, the current monetary system fails to comply with even the most basic Christian moral rules, such as the prohibitions against theft and fraud and the call to practice biblical financial stewardship. The great Christian thinkers of the late medieval and early modern period typically condemned the type of monetary debasement that has occurred, and continues to occur, in the current monetary system of the United States of America.

This monetary debasement taints our present monetary system primarily because the currency we use possesses no precious-metal backing. In 1933, the federal government removed the gold backing from our currency (which until that time had been convertible into gold) and forced people to turn over their stocks of gold. This was nothing other than a massive act of confiscation. The paper currency continued to circulate out of habit, so accustomed had we become to its use. But it had become convertible into nothing. Its lack of convertibility made it what economists call "fiat money," as opposed to the "commodity money" we had when our currency was convertible into gold. This is all a nice way of saying that the government unabashedly violated God's commandment not to steal. We can hardly be surprised that such disobedience should have had such regrettable consequences.

The best-known difficulty with a fiat currency is inflation. Inflation, wrongly described by many people as rising prices (a mere *effect* of inflation), refers to an increase in the amount of paper currency in circulation. With respect to commodity money, inflation refers to an increase in currency that does not correspond to an increase in the commodity into which the money is convertible. Thus, commodity money provides an inherent check against inflation. The ever-present demand by depositors for redemption of bank notes into a commodity such as gold prevents any sustained inflation of the money supply, since the issuing institution finds itself unable to settle all the inevitable claims for conversion of the inflated notes into gold. Gold possesses the advantage of being finite in quantity and impossible to counterfeit. But if deposits are redeemable in nothing but worthless paper, a crucial check against monetary expansion has been removed. There is practically no limit to the amount of paper that can be printed and stamped as money.

An important if frequently overlooked feature of inflation is its "distribution effects." Inflation of the money supply leads to rising prices or, at the very least, to prices that are higher than they would have been in the absence of the inflation. But the price increases

associated with inflation do not occur all at the same time, reaching all goods instantaneously across the entire economy. The new money does not enter the economy in a uniform way; rather, it affects everyone in different degrees at different times. Some get the new money earlier than others. Those who receive the new money first are able to spend it in an economy in which prices have not yet risen. Those who receive the new money from its first recipients, in turn, find themselves at an advantage vis-a-vis those who have not yet received it, because prices have likely not yet risen to a level commensurate with the new quantity of money.

As the new money works its way through the economy, it raises the prices of the goods that its recipients purchase. Those who receive the new money last, after it has worked its way throughout the economy, suffer the brunt of the distribution effect, because all this time, without having come into possession of any of the new money, they have had to pay the higher prices that the new money has brought about. We now see that the distribution gains of the first possessors of the new money have come at the expense of those who received the money only much later. If there is a principle of Christian morality according to which such insidious wealth redistribution is acceptable, it is not known to the present writer.

Inflation also hurts those on fixed incomes and those who rely for their sustenance on accumulated savings. In either case, the same nominal amount of money possesses less real purchasing power as a result of the government's increase of the money supply, and practically everyone—particularly the most economically vulnerable—thereby become the victims of indirect theft. Thus, the government's illicit confiscation has begotten more theft, visiting the harmful effect of this sin "to the third and fourth generation."

Furthermore, inflation also throws business calculation into chaos. Under an inflationary regime, businesses find it difficult to distinguish between genuine and illusory profits. Basing themselves on nominal expenditure and revenue figures, they tend to overestimate profits, mistaking the consequences of an inflated money supply for an increase in real profits. It is standard accounting practice for an asset's cost to be reckoned as the amount of money spent to purchase it. But when inflation occurs, the price of replacing that asset when it wears out rises. Thus, inflation causes businesses to overstate their profits, because it encourages them to not properly take into account the now higher replacement costs of their assets and even to spend and invest money that they actually need just to maintain their capital stock. In other words, by misleading businesses into a false sense of prosperity, inflation can cause business executives to engage in inadvertent capital consumption, thereby causing executives to commit fraud—whether advertently or inadvertently—when preparing their financial statements. On the other hand, commodity monies, as Hans Sennholz has pointed out, can actually facilitate economic calculation, because their quantities tend to change so slowly. Inflationary activity thus profoundly disrupts the common good no matter how that concept is defined.

Inflation's interference with business calculation is not insubstantial. As the distribution effects of inflation work their way through the economy, business firms may see the prices of the goods they produce begin to rise. If entrepreneurs be lieve that these price

rises represent a permanent phenomenon, they are liable to expand production, investing in additional capital and labor. If, on the other hand, they believe that these price increases are caused simply by inflation and are not likely to be long lasting, they will refrain from rearranging resource allocation in line with the rising prices. The trouble is that they have no way of knowing whether given price increases are caused by genuine increases in demand or by inflation. They have no way of knowing the specific path of the inflation as it works its way throughout the economy, and whether their own firms are part of that path. "Inflation," writes Steven Horwitz, "is a major drag on economic growth because it unnecessarily complicates the entrepreneur's job and leads to error and wasted resources." Thus, in addition to encouraging fraud, inflation discourages the practice of biblical financial stewardship.

This discouragement of biblical stewardship extends beyond distinctly business environments. "The millions who see themselves deprived of security and well-being become desperate," explains Ludwig von Mises. "The realization that they have lost all or most all of what they had set aside for a rainy day radicalizes their entire outlook. They tend to fall easy prey to adventurers aiming at dictatorship, and to charlatans offering patent-medicine solutions." These effects are "especially strong among the youth. They learn to live in the present *and scorn those who try to teach them 'old-fashioned' morality and thrift*" (emphasis added). Inflation thereby encourages a mentality of immediate gratification that is plainly at variance with the discipline and eternal perspective required to exercise principles of biblical stewardship—such as long-term investment for the benefit of future generations.

Before moving on, let us consider one additional point about a fiat currency. One implication of Mises' regression theorem (which he developed in *The Theory of Money and Credit*, 1912) is that the only way a fiat money can arise is by means of government confiscation of the precious-metal backing of existing commodity money, thereby transforming the paper currency, at one time convertible into a precious metal, into worthless, irredeemable paper. If Mises is right, this point must surely enter our moral calculus—if fiat money can come about only as a result of massive government confiscation, its moral status may well be fatally compromised on that ground alone.

Beyond inflation, a very serious problem associated with fiat money is the boom-bust cycle. It was Ludwig von Mises (1881–1973) who developed the so-called Austrian theory of the business cycle, and his student F. A. Hayek (1899–1992) whose elaborations on it won him the Nobel Prize in economics in 1974.

Space considerations prohibit all but the briefest overview of the theory here, but what follows may serve at least as an introductory sketch. When the Federal Reserve engages in monetary expansion through credit markets (to "stimulate the economy," so we are told), the effect is to lower the interest rate. Normally, the interest rate coordinates saving and investment. When people save more, the interest rate goes down. The lower interest rate, in turn, alerts entrepreneurs to the correspondingly increased availability of funds to be borrowed. The increased saving also reflects the public's increased willingness to defer consumption. This, naturally, is when investment projects make the most sense.

Also, the lower interest rate gives a disproportionate stimulus to "higher-order" stages of production like mining or raw materials—that is, stages furthest away from finished consumer goods.

The problem with the Fed's stimulus is that by artificially lowering the interest rate it makes investors think that the public is more willing to defer consumption than it actually is. It makes investors think the public has saved more than it actually has. But the public's saving/consumption preferences, in this scenario, have not changed at all. Business executives are led to engage in an expansion in higher-order stages of production that is completely at odds with the public's unchanged desire for consumption in the present. They begin projects that cannot all be completed given existing resources. The resulting misallocation of capital and overall economic discoordination eventually bring the artificial boom to an end.

Mises' analysis reinforces the moral claim of a pure gold standard, because if all money were convertible into gold on demand, no central bank would be able to engage in the kind of credit manipulation and stimulus that leads to the business cycle in the first place. Surely if a particular monetary system can avoid the impoverishment and dislocation of recessions and depressions, this factor alone should speak volumes in its favor.

Moreover, the Austrian theory also contains critically important insights for proper moral analysis and shows why moral judgment is liable to go dreadfully wrong if undertaken in ignorance of the true causes of the business cycle. Countless moralists are to be found during recessions and depressions calling for various state measures intended to alleviate the dislocations associated with the downturn. Since this topic is well covered in the Austrian literature, let us confine ourselves to one typical suggestion: emergency aid, from low-interest loans to outright subsidies, to failing businesses. As the Austrian analysis makes clear, this is precisely what should not be done, because it only perpetuates the credit-induced misallocation of capital into the indefinite future. Liquidation of the malinvestments incurred during the boom must be allowed to continue unimpeded, lest the inevitable liquidation process and its attendant suffering be indefinitely prolonged.

In fact, the policy implications of the Austrian theory are obvious: the government should do nothing at all. Any attempt to lend support to malinvested capital only obstructs the recovery. Economically sound firms are forced to continue to compete with these unsound firms for the scarce resources they need. Support for failing businesses thus tends to impoverish those firms that are capable of employing the resources of their less successful counterparts more efficiently and more in line with consumer demands and time preferences but they are impeded from doing so. Government stimulus to consumption, which remains the conventional wisdom despite its repeated failure (as in Japan, which has been in the economic doldrums after some fourteen years of consumption-driven policy), is at least as bad an idea as supporting failing businesses. Business downturns are not caused by insufficient consumption. In a certain sense, a downturn is caused by too much consumption, making long-term investment projects correspondingly unprofitable (because they were out of line with consumer desires to

consume in the more immediate future). This is why Murray Rothbard suggested that the most helpful path to pursue at such a time is certainly not more consumption, but "more saving, to vali date some of the excessive investments of the boom."

The importance of economic knowledge to moral analysis is, therefore, amply reinforced in the case of the business cycle. Without an adequate knowledge of the causes and cures of the cycle, someone trained in moral philosophy or theology cannot be sure that he is not in fact recommending a course of action that will only exacerbate the problems he aims to solve. One prominent Catholic writer during the 1930s wrote that the cause of the Great Depression, "supposedly so complex," could be distilled to "one word: greed." Such pronouncements are, to say the least, unhelpful. Even if greed magically disappeared, misleading signals to investors would still lead to the misallocation of capital described in the Austrian theory.

The practice of fractional-reserve banking, which lay at the heart of modern banking systems, also carries moral implications. A fractional-reserve bank is one that lends out much of its demand deposits (that is, funds that its clients are entitled to at any moment, on demand) at interest, trusting that a critical mass of its clients will not demand their money simultaneously and that the money the banks keep in reserve—a mere fraction of their liabilities—will suffice to meet the demands of those who do demand their money. Banks that engage in this practice are inherently bankrupt. If all their clients simultaneously demanded that their deposits be turned over to them, the bank would be forced to concede its inability to meet its obligations. The only case in which it would be morally legitimate for a depositor's money to be treated as temporarily not his own would be in the case of a time deposit, in which case the depositor would have voluntarily contracted to relinquish control over his money to the bank for a set period of time, during which the banker could do with it as he saw fit.

In many cases, governments have granted favors and special privileges to such banks. Very often, fractional-reserve banks, under pressure for redemption from depositors, have been legally permitted to suspend payment to their depositors—which means they are allowed to continue in operation, demanding that their own debtors meet their obligations, while at the same time refusing the just claims of their creditors (i.e., their depositors). Sometimes this privilege has lasted years at a time. No other business is allowed to operate on such a basis, and there is no obvious moral difference between banking and any other business enterprise that should entitle it to exemption from this basic standard of morality.

The late scholastic theologians were generally unfavorable toward fractional-reserve banking as well. In the sixteenth century, such theologians as Luis Saravía de la Calle, Martín de Azpilcueta Navarro, and Tomás de Mercado argued that the demand deposit did not amount contractually to a transfer of property, even for a time, from the depositor to the banker, and that it would be wrong for the banker to attempt to seek profit by lending out deposits that were supposed to be available to depositors on demand. Even in the case of such scholastics as Luis de Molina and Juan de Lugo, whose position was rather confused but which appeared to favor the principle that the depositor forfeited

some control over demand deposits to the banker, a modern scholar suggests that they would nevertheless have rejected the fractional-reserve system when presented with all of its implications. Fr. Bernard W. Dempsey has shown that on the basis of their own principles, even these men, faced with the modern system, would have favored a banking system based on one hundred percent reserves or something very much like it.

The issues that arise over questions of money and banking serve to remind us of the complementary roles of economics (a purportedly value-free science) and morality. Without economic knowledge, the moralist's advice can prove profoundly misguided and even destructive. A sound moral foundation, in turn, is necessary for us to evaluate existing economic institutions in light of genuine principles of justice.

In sum, the best monetary regime, from the point of view both of utility and of Christian morality, is a one hundred percent reserve commodity money system. This system alone is free from all forms of fraud, requires no confiscation of a person's property, creates no disincentives to honor our stewardship responsibilities, keeps the business cycle at bay, and avoids the immoral distribution effects and erosion of accumulated wealth that inevitably accompany a system of fiat money. What this means, in short, is that that monetary system is best which observes the most basic moral rules: Do not steal and do not commit fraud. This was the message of the great Christian thinkers of the late medieval and early modern period, who typically condemned monetary debasement, and it is a message that their modern-day counterparts would do well to heed.

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