

Morality, Money, and Banking

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Introduction

Thank you. May I begin by saying that it is very good to be back in Argentina. Ladies and Gentlemen. My topic today is morality, money and banking. With the global economy still experiencing ongoing aftershocks from the 2008 financial crisis, we need no lessons today about the vital role played by money and banking in producing economic prosperity or economic decline. Though Latin America has avoided many of the problems of America and Europe's financial sectors, Latin American countries know, through hard experience, what happens when currencies and banking sectors enter a state of crisis. Anyone who lived through Argentina's debt-crisis of 1999-2002 understands what happens when confidence in monetary arrangements and the solvency of the financial industry slowly collapses.

In such circumstances, it is not primarily the wealthy or the powerful who suffer. They have the resources and political connections to survive relatively unharmed. Rather, it is those in poverty, those on fixed incomes, and those living off savings who find themselves in desperate circumstances.

There are, however, two other often forgotten groups negatively affected by monetary instability or a weak banking sector. These are businesses seeking to expand as well as entrepreneurs wishing to seize new opportunities to create wealth. Both groups usually need to borrow capital if they are to realize their goals. But capital becomes a scarce resource when banks are trying to reduce their exposure, or when there is uncertainty concerning a currency's viability.

Availability of capital is also highly dependent upon the

degree to which institutional conditions, such as protection of basic property rights, are present in an economy. In a global economy, people are free to invest their capital in countries where such institutional protections prevail. They are also free to withdraw their investment whenever these institutional guarantees weaken.

Stable money and a profitable banking sector are thus indispensable for poverty alleviation, because the only long term solution to poverty is not wealth redistribution. The only way to reduce poverty in a sustainable manner is through wealth-creation. And wealth-creation is, in turn, vitally dependent upon commerce and entrepreneurship – neither of which can be sustained without capital that comes in the form of money and which is managed by the financial sector.

It is with this background in mind that I want to discuss two things today. First, I want to briefly reaffirm the basic morality of the practice of credit, not least because it has always been viewed with moral suspicion. Second, I want to outline what I think are some fundamental choices that we need to make in the future if we want money and the financial sector to serve as vehicles for long-term prosperity and poverty-alleviation rather than sources of chronic economic instability.

Usury, Money, and Capital

Though the 2008 financial crisis certainly damaged the reputation of the banking industry throughout the world, suspicion of those who are in the business of credit is not

new. While financial scandals have contributed to this situation, it also owes something to the historical debate about the morality of charging interest.

Today, we often forget that credit and charging interest was a morally controversial subject in the Christian West for centuries. Few remember, for example, that in his *Wealth of Nations* Adam Smith advocated usury laws to limit the amount of interest that could be charged. It was not until 1836 that the Catholic Church formally removed all existing doubts among Catholics by decreeing that interest may be charged by everyone. Of course the Church continues to regard usury as a sin. But let us be clear about this: by usury, the Church means “the act of taking profit on a loan without just title”. I repeat: “without just title”. This was a dogma of the Church 900 years ago and it

remains a dogma of the Church today. And this is reasonable, because no economic claim – whether it is a claim to interest or a claim on a good or service – can be sustained if the claim is based on an unjust title.

Moreover, it was precisely through debating subjects such as the meaning of “just title” and the nature of money that Catholic thinkers achieved significant intellectual breakthroughs that facilitated today’s modern system of credit. First, they identified money’s four basic market functions: a medium of exchange, a store of value, a unit of account, and a standard of deferred payment.

Second, they established that money was not, as Aristotle held, something sterile and barren. Through focusing on the moral significance of phenomena such as risk and value,

they were able to illustrate that money was in fact – to use their language – a “fruitful thing”. In other words, money was also capital: something to which its owners can claim a just title, which they therefore can lend to other people, and in return for which they can legitimately charge others a fee for its use. Even today, this understanding of money-as-capital constitutes one of the primary moral foundations for modern financial entrepreneurship, ranging from the simplest loan to highly sophisticated credit arrangements.

There is little question that discussion and clarification of the usury question played a crucial role in the rise of market economies in Europe and eventually North America. But I would like to suggest today that the focus upon usury over the centuries actually distracted us from another problem – one especially pertinent for our present

circumstances. This is the conflict between money's four basic functions in a market economy, and money's role as a tool of government economic policy.

Centralized or Decentralized Money

In his famous critique of the Treaty of Versailles, *The Economic Consequences of the Peace* (1919), John Maynard Keynes observed: "Lenin is said to have declared that the best way to destroy the Capitalist System was to debauch the currency." History, however, illustrates that the greatest debauchers of money have not been Communist revolutionaries or even common counterfeiters. The primary culprits have been entirely legitimate governments.

Writing in the fourth century B.C., for example, the Greek philosopher Diogenes described money as “the legislators’ game of dice.” Almost 2000 years later, the scholastic theologian Juan de Mariana wrote an entire treatise, *De monetae mutatione* (1609), assailing governments for devaluing currencies in pursuit of immoral ends. As a result, Mariana was charged with treason and sentenced to life-imprisonment in a Franciscan monastery. 152 years after Mariana’s death, Adam Smith complained that “in every country in the world . . . the avarice and injustice of princes and sovereign states abusing the confidence of their subjects, have by degrees diminished the real quality of the metal, which had been originally contained in their coins”.

These observations reflect an on-going problem with governments’ management of the money-supply.

Sometimes this has devastating consequences. Few today, for example, would question the contributions of flawed monetary policy to the Great Depression, the stagflation of the 1970s, or the 2008 financial crisis.

There have, of course, been attempts to address this problem. The idea of central bank independence arose from a desire to dilute the ability of populists and politicians with short-term horizons to influence monetary policy. Likewise, one of the gold standard's chief attractions was its ability to constrain governments from succumbing to demands from interest groups for cheap money.

In this light, it is surprising that proposals to remove government from the business of money-supply altogether only began to emerge in the last quarter of the twentieth

century. In his book, *The Denationalization of Money*, the Nobel Prize economist Friedrich von Hayek sketched a powerful economic argument for ending the state's monopoly of the money-supply. This has been developed by scholars such as Jesús Huerta de Soto whose book, *Money, Bank Credit, and Economic Cycles*, contains a comprehensive plan for privatizing the money-supply.

The technical viability of such proposals continues to be debated. A separate question, however, is whether there is any *principled* reason for the state – either directly or indirectly through central banks – to monopolize the money-supply. The fact that governments sometimes perform their designated functions ineffectively or even occasionally abuse them is not in itself sufficient reason to strip the state of a given responsibility.

One reason traditionally given for the state's monopoly of the money-supply is that it is an expression of national sovereignty. While sovereignty's meaning is endlessly debated, there is agreement that sovereignty expresses a government's supreme authority over a given territory. In the mid-fifth century B.C., for example, Athens compelled her allies to adopt Athenian coinage – a move that signaled Athens' expanding sense of the territorial boundaries of its sovereignty. The scholar who most developed the modern concept of sovereignty, Jean Bodin (1530-1596), identified the right to issue coinage as a key element of sovereignty. In our time, some of the most contentious debates surrounding the euro have concerned its reduction of the national sovereignty of EU member-states adopting this transnational currency.

But is a state monopoly of the money-supply truly essential to sovereignty? Let us remember that when Adam Smith listed “the only three duties [which] . . . the sovereign has to attend to”, he did not include the supply of money.

Some clarification begins to emerge when we consider the purpose of money. It is not immediately clear why any of money’s four basic market functions necessitate a state monopoly of the money-supply. Money is certainly a commodity unlike any other economic good. But there is no obvious reason why attempts to undermine money’s ability to perform its market functions could not be addressed through the ways we address most other economic crimes. As noted by the distinguished nineteenth-century English jurist Lord Farrer, contract law, tort law,

and criminal law are more than sufficient to adjudicate such matters without invoking any special law of legal tender.

A different understanding of money, however, is often used to justify the state's monopoly of the money-supply. This is the claim that money is also a tool for the state's management of an economy. This occurs through methods such as setting official interest rates or what today is euphemistically called "quantitative easing": that is, printing money. None of these techniques for regulating the amount of money in circulation would be effective if governments did not enjoy a monopoly of the money-supply.

This monopoly is of course predicated upon the much disputed claim that the state *can* effectively steer an

economy so that it serves the common good. The link to sovereignty is the state's need to invoke a unique authority that allows it to claim responsibility for managing the economy within a defined set of territorial boundaries.

The problem is that there are many occasions when the state's monopoly of the money-supply involves the pursuit of goals that undermine money's ability to perform its four market functions. A government's adoption of inflationist policies to reduce public deficits, for example, undermines money's ability to serve as a stable unit of value over long periods of time.

So – is there any way to resolve this tension between what might be called “state-centered” and “market-oriented” views of money's functions? Here we should note that

concerns about sovereignty are diminishing just as quickly among “centralizers” as they have long disappeared among “privatizers”. In 2009, for example, a United Nations panel of experts chaired by another Nobel economist, Joseph Stiglitz, proposed creating a global reserve currency. This implies all nations ascribing some of their sovereignty to an international organization, much as many EU members have done with regard to the European Central Bank. Indeed the panel recommended giving responsibility for managing such a currency to either the IMF or a newly created “Global Reserve Bank”.

In one sense, the centralizers are pushing at an open door. Economic globalization has already diluted national governments’ ability to use their control of the money-supply to “manage” domestic economies. Fluctuating

exchange rates and the ability of traders to transfer billions across national boundaries by pressing a keyboard have also reduced most governments' ability to control their national currencies. In short, sovereignty is slowly becoming irrelevant.

The difficulty for centralizers such as Stiglitz is how they address the fact that the record of a Global Reserve Bank's management of monetary policy for the global economy is likely to be as undistinguished as the record of most national central banks in directing monetary policy for national economies. No matter how sophisticated the statistical information and mathematical resources at their disposal, it is simply impossible for any group of central bankers to know, for example, what is the optimal interest-rate for the world economy in the present, let alone nine

months in the future. Mistakes, perhaps with enormous consequences, would inevitably be made.

Unfortunately the contribution of flawed monetary policy by national central banks such as the United States Federal Reserve to the 2008 financial crisis is creating some momentum for the international-centralizers. But perhaps the good news is that decreasing worries about sovereignty are clarifying what is really at stake when it comes to creating the stable monetary frameworks upon which economic prosperity depends. Is the key to successful long-term monetary stability further centralization of the money-supply? Or, should we investigate decentralizing options which treat money much as we treat most other essential commodities (such as food) and rely upon market-oriented solutions? This is the choice we all face.

Conclusion

So to conclude: it is not coincidental that the two groups most resistant to market-oriented solutions to the problem of unsound monetary arrangements and an unstable financial sector are governments and bankers. Governments are notoriously reluctant to remove themselves from any arena which they are already control. Indeed many have already used the 2008 financial crisis as an excuse to reassert their control over independent central banks. A market approach to addressing money-supply issues would also weaken the ability of populists and politicians to use the state's monopoly of the money-supply to placate numerous pressure groups at the expense of the common good.

Many bankers, however, are equally opposed to any move towards market-oriented solutions. No doubt, this is partly because they are familiar with the present system even though they forget that today's banking system has existed for only 200 years. Another reason, however, is that if we removed the state's monopoly of the money-supply, bankers would lose their present ability to privatize their gains and socialize their losses. They would become accountable for their actions in the same way that any other business is held accountable – by its success or its failure in the marketplace.

There is, of course, no such thing as perfect monetary arrangements or a banking system invulnerable to instability. Humans are fallible. There are no utopias in this

world. This does not, however, excuse us from thinking creatively about how to resolve apparently chronic problems in monetary systems around the world – problems that help keep people in poverty. Given the sad historical record of state-centered strategies of economic management, prudence suggests we should at least seriously investigate private options. Unfortunately we may have to await more catastrophic monetary errors by central bankers and fiscal errors by governments before we allow ourselves to think – and perhaps do – the presently unthinkable. Thank you.