The Popes have directly and indirectly taught that money ought to serve man and be used for the common good. They have also condemned the idolatry of money and warned those who manage it for society to do so responsibly and according to the principle of subsidiarity. Money is the “life-blood” of the market economy, yet its creation and distribution is widely misunderstood in the United States. The Federal Reserve has less control over the money supply than is commonly thought because of their commitment to provide an elastic currency, and the federal government must maintain monetary sovereignty in order to pursue the goals of full employment and price stability. Though an elastic currency and monetary sovereignty are potentially inconsistent with Catholic teaching, they are not inherently so, as long as those with power act for the good of all.

A. INTRODUCTION

Catholic social teaching and natural law govern the moral aspects concerning the creation and use of money because of its centrality to our decisions about spending, saving, and borrowing. Indeed, Pope Pius XI once called money the “life-blood” of our economy because of its role in providing access to goods and services. It is clear that money plays a vital role in a well-functioning market economy. However, there is much misunderstanding concerning the nature of money and how it is created in many modern nation-states, including the United States.

Money is fundamentally an IOU or credit-debt relationship. Banks create money when they extend credit as is conventionally thought, but are able to do so unconstrained by the monetary base. The Federal Reserve System bears enormous responsibility in managing the U.S. dollar and governing the U.S. banking system, but it does not control the money supply. Its original purpose was to maintain the monetary payments system by providing an elastic currency. Providing liquidity on demand is still one of its primary functions, though it receives less attention than the Fed’s setting of interest rates to control inflation and lower unemployment.
Monetary sovereignty is often a power that nations claim for themselves as an extension of their legal sovereignty. The U.S. claims this sovereignty through the creation and taxation of their own unit of account—the U.S. dollar. Monetary sovereignty is necessary in order to employ fiscal and monetary policies that pursue full employment and price stability.

This paper examines the nature of money and monetary sovereignty, and the structure of the U.S. banking system, including the Federal Reserve’s role in providing an elastic currency, all from the perspective of the Church’s teaching on the right use of money and monetary policy.

**B. CATHOLIC TEACHING ON RIGHT USE OF MONEY AND MONETARY POLICY**

Relative to other elements of the economy, such as wages or development, money is scarcely mentioned in Church documents. Use of the term almost exclusively involves the right use of money. For example, Pope Leo XIII warns the reader that riches are obstacles to happiness in this life and the next: “It is one thing to have a right to the possession of money and another to have a right to use money as one wills” (Leo XIII 1891: §22). Property and money are to be used for enrichment of the soul and for the benefit of others. Rest on the Sabbath and other holy days is not license for idleness nor for indulging one’s appetites by spending money (Leo XIII 1891: §41). Using persons merely as a means for making money is also sinful (Leo XIII 1891: §42). The all-consuming desire for profit is sinful, even rising to the level of a structure of sin (Paul VI 1967: §26, John Paul II 1987: §37).

The Popes have also rebuked those who abuse their power over the economy or monetary system. Pius XI was quite harsh on the wealthy classes, reproaching them for their lack of concern for the poor. In particular, he criticized the dictatorship consolidated in the hands of the bankers who controlled the access to credit and the investment of funds (Pius XI 1931: §§105–07). It is in this context that Pius calls money or credit the “life-blood whereby the entire economic system lives” (Pius XI 1931: §107). It is clear that Pius called for this “life-blood” to be accessible to everyone, especially to those most in need of it, and to be used for the common good rather than as a mere instrument for money-making. Likewise, Pope John Paul II criticized the use of large sums of money for the enrichment of already wealthy groups or individuals or the building of stockpiles of weapons instead of for the development of communities with less means of subsistence (John Paul II 1987: §10).

Like his predecessors, Pope Francis has condemned the idolatry of money, of which we often “calmly accept its dominion over ourselves.
and our societies” (Francis I 2013: §55). According to Francis, the recent financial crisis was rooted in a human crisis borne of the economic dictatorship that lacked a human purpose. Likewise, Francis denounced ideologies that grant absolute immunity to the financial system, as well as the control of people and poor nations with debt and interest (Francis I 2013: §56). At the root of these grave errors, creating an economy of exclusion, is the rejection of God and ethics (Francis I 2013: §§57–58).

Though Papal teaching is largely silent on specific matters of monetary policy, the pastoral letter *Economic Justice for All*, published by the United State Conference of Catholic Bishops (USCCB) in 1986 does address this topic. The Council “recommends that the fiscal and monetary policies of the nation—such as federal spending, tax and interest-rate policies—should be coordinated so as to achieve the goal of full employment” (Catholic Church 1986: §156). These policies must also consider the effects of inflation and attempt to maintain price stability, but not at the expense of abandoning the goal of full employment (Catholic Church 1986: §157). The Bishops state the case that economic growth is necessary but not sufficient for achieving full employment—more specifically aimed policies are required to achieve that result (Catholic Church 1986: §158). Furthermore, the Bishops rightly recognize that the economy is always embedded in a particular social, historical, and political context. Although economic freedom is vital, there will always be a role for government (Catholic Church 1986: §313).

However, Papal teaching does address the proper role of public authorities extensively throughout the encyclicals. The goal of all social action, including that of the government, is the common good, “the sum of those conditions of social life which allow social groups and their individual members relatively thorough and ready access to their own fulfillment” (Paul VI 1967: §26). Papal teaching has made clear that the government does have a role to play in pursuing the common good, but it must follow the subsidiary function, or principle of subsidiarity, where the lowest level of society able to achieve all that pertains to it should be left free to do so by higher levels of society (Pius XI 1931: §80, Catholic Church 2005: §185). More specifically, it is expected that the monetary authorities set policy so as to pursue the common good and that those policies do not infringe upon the rights and responsibilities of lower-level institutions.

In summary, Catholic Social Teaching expressly condemns the idolatry of money, commands societies to ensure adequate access to money for all people, especially the poor, and demands the right use of it by families, businesses, banks, and the state. Monetary policy should be directed toward full employment and stable prices and to the common good more
generally, all while following the principle of subsidiarity. The following sections will examine monetary policy and money and banking in the United States through the lens of Catholic teaching on these same matters.

C. MONEY AND MONETARY SOVEREIGNTY

The right use of money requires a right understanding of money and its elements. Money is conventionally defined as “anything generally acceptable in payment for goods and services or in the repayment of debts” (Mishkin 2006: 44), as well as by its functions, chiefly performing as a medium of exchange solving the problem of barter, but also as a unit of account and a store of value. Though the nature and history of money are contested by two traditions frequently labeled Metallism—or the Currency school—and Chartalism—or the Banking school—this article will focus exclusively on its current features in the United States.

Modern money in the United States is a fiat or nonconvertible money, distinguishing it sharply from a commodity money or metallic-standard money (Federal Reserve Bank of Chicago 2014). The United States declares the dollar as legal tender and promises to exchange it only for itself at its public pay offices—Federal Reserve Bank branches. The value of the dollar is free to float with respect to gold, other goods, and other currencies.

The ‘dollar’ primarily exists as numbers in digital space, that is, in bank accounts, which are stored on computer servers, but also as the more traditional paper currency or metallic coins. The paper and coins are themselves worth very little and much less than the nominal worth of the coin or piece of paper, and the digital money is intrinsically worth nothing at all. The dollar, then, is a token currency since its intrinsic value is worth much less than its extrinsic value.

Furthermore, the U.S. money supply as measured by the ‘M1’ aggregate is composed of outstanding currency and checkable deposits (Meulendyke 1998). Checkable deposits, in addition to being numbers in digital space, are simply IOUs or credit-debit relationships (Innes 1914, Wray 2012). Checkable deposits are the asset or credit of the depositor and the liability or debit of the bank. The bank must grant the asset holder his dollars on demand. Additionally, the cash deposited by the customer is the bank’s asset, which is normally deposited in the bank’s bank—the local Federal Reserve Bank—making it the liability of the central bank. Viewed in this light, it is clear that all M1 money is either the liability of the Federal Reserve Bank or of private banks.

Bank money (checkable deposits) trades at par with state money (currency), all denominated in dollars or the state’s unit of account (Wray
2012). U.S. dollars are the state’s creation. Banks are able to trade their own bank notes for state notes at par because of the structure of the Federal Reserve System, which will be discussed further below. Other IOUs, such as the ones individual citizens or businesses might create, are less able to trade at par with state notes and are thus not frequently if ever used as money (Bell 2001).

State IOUs are at the top of the hierarchy of money primarily because of taxation (Bell 2001, Tcherneva 2006). U.S. citizens use the U.S. dollar in daily transactions because of its general acceptability, which is, in turn, a product of the state’s ability to require its citizens to pay taxes in its preferred unit of account. By imposing a liability of dollars on its citizens, the state is creating demand for and thus value for that thing which it taxes—in this case, dollars. The U.S. government taxes its citizens in order to purchase services and goods to perform the functions it claims for itself. Common sense says the government must tax first before being able to spend, but this logically cannot be the case if the government taxes in something it creates. The government can’t collect something that doesn’t exist. Legally, the Treasury must tax or borrow to spend, so this logical order is obscured by a self-imposed legal constraint. Nevertheless, taxes and bond issues primarily serve to allow the government to buy the goods and services it needs to perform its functions. As the issuer of the dollar, the U.S. government does not need to fund its purchases with taxes and security issues, but trying to spend without doing so could cause an increase in inflation (Wray 2012).

The power to tax and issue its own currency is one component of the sovereignty that many states claim. In the United States, the Constitution and the entire body of laws confirm the sovereignty the government claims for itself. States are defined by their legal domestic sovereignty, including legislative, judicial, and military sovereignty, but also frequently monetary sovereignty (Mundell 2002). It is likely that states that claim these primary types of sovereignty that provide the foundation for an independent nation-state will also claim monetary sovereignty, because monetary sovereignty offers governments a great deal of power and flexibility in carrying out their other forms of sovereignty, as well as in achieving their economic goals. This has been called the ‘one nation, one currency’ rule, because of the tendency for legally sovereign nations to also wield monetary sovereignty (Wray 2012).

There are examples of states abandoning monetary sovereignty for various reasons, including nations in the European Monetary Union; however, these nations give up the ability to respond to economic crises by running government budget deficits (Bell 2002).
Most people are aware that the U.S. dollar is a fiat currency. Many express concern over that fact, but most ignore it or are unconcerned because their money works all the same. However, it is not well known that money is fundamentally a credit-debt relationship that is intimately bound up with the state and its various levels or kinds of sovereignty.

**D. UNITED STATES BANKING SYSTEM**

The U.S. banking system is complex, and detailing all of its complexities extends beyond the scope of this investigation. Instead, it will suffice to understand its general framework and the implications of that framework.

The central bank of the United States, the Federal Reserve Bank (FRB), is composed of twelve regional banks, not one single bank. Some Reserve banks also maintain several branches. Reserve banks are owned by member banks and provide banking services for all banks. Non-member banks still have access to Reserve bank services and must meet certain federal regulations including reserve requirements, but are generally subject to fewer regulations as governed by their respective charter-granting state. Member banks have the power to elect some members of the board of governors of the reserve banks. The primary difference between member and non-member banks is stock ownership in the FRB.

Despite private ownership, the FRB is decidedly quasi-governmental. Congress instituted it and mandated that it form policy to meet specific economic goals. The Chairman and members of the Board of Governors are appointed and confirmed by the President and Senate, respectively.

The primary functions of the banking system as a whole are to provide depositary services and extend credit. However, the process by which credit is extended and thus new money created is widely misunderstood. Commercial banks create new money when they extend credit to a borrower. Understanding that money is an IOU, the commercial bank in effect creates a new bank note or IOU when it grants a loan, or rather it monetizes the borrower’s IOU. The loan is recorded as a double entry where the bank’s liability is the new bank note or demand deposit and its asset is the accounts receivable—the principal plus interest owed by the borrower. New loans are new bank notes that trade at par with FRB notes. Bank notes carry two promises: (1) acceptance back in payment of loans to the issuing bank and (2) convertibility to FRB notes or cash (Wray 2012: 93). FRB notes are more commonly known as dollars or reserves depending on the form they take. In fact, all new money is created by new loans, which means that the expansion of the money supply is an expansion in the number of promises (promissory notes) or credit-debt relationships.
Conventional economic thought argues that the extension of credit is limited by the FRB’s reserve requirement (Fullwiler 2008). This theory, known as the monetary multiplier, asserts that credit and thus the money supply can and will be extended as a multiple of required reserves to the rate of one over the required reserve ratio. However, in reality, banks are able to extend credit beyond that which is allowed by the reserve requirement and obtain reserves in the fed funds market at the fed funds rate as targeted by the FRB (Fullwiler 2008). That is, banks can extend credit as they see fit and obtain the reserves later to meet the reserve requirement and any additional demand they have for reserves. Put simply, loans create deposits, and deposits create reserves. This means that the FRB does not control the money supply, which will be made more clear in the following section.

E. THE FEDERAL RESERVE GUARANTEES AN ELASTIC CURRENCY

By passing the Humphrey-Hawkins Act in 1977, Congress amended the Federal Reserve Act, mandating that the FRB’s twin objectives are full employment and low inflation. Originally, the FRB was created to stem the tide of financial crises by providing an elastic currency (Meulendyke 1998: 20). The provision of reserves on demand is often called the lender-of-last-resort function. The FRB is also tasked with supervising and regulating banks, providing financial services for banks and the U.S. Treasury, and maintaining the U.S. payment system, which includes printing paper dollars (Federal Reserve Board 2005).

The FRB has at its disposal several tools to accomplish its monetary policy goals of full employment and low inflation, but the primary tool is open market operations (OMOs) or buying and selling treasury securities from or to primary dealers. The FRB conducts OMOs so as to target the fed funds rate (FFR), also known as the overnight lending rate (Fullwiler 2008). The fed funds market is a market for reserves where banks can buy or sell reserves at the going rate. The FRB has an interest in the FFR because the FFR serves as a benchmark for all other interest rates (Atesoglu 2003). It is the FRB’s belief that by lowering and raising the FFR, they can affect unemployment and inflation so as to hit their targets. Lowering the FFR tends to lower all interest rates, which makes money or credit cheaper, which in turn is supposed to stimulate spending and investment, and thus lower the unemployment rate. Raising the FFR is supposed to have the opposite effect.

The FRB recently increased its target FFR to 0.25–0.50% from 0.00–0.25%, where it had stood since October 2008. Unconventionally, the FRB is also paying interest on reserves in order to make it possible to load
banks’ balance sheets with reserves to ensure their liquidity and make possible greater extension of credit (Federal Reserve Bank of San Francisco 2013). Normally, when the fed funds market is flush with reserves, the FFR drops, which necessitates that the FRB sell Treasury securities to its primary dealers to remove those excess reserves from the fed funds market so as to maintain the FFR within its target. The opposite happens when there is a shortage of reserves in the fed funds market. The shortage triggers a rising FFR, which then makes it necessary for the FRB to buy treasury securities from primary dealers, injecting the market with reserves and lowering the FFR back within its target.

It should now be clear that banks can extend credit beyond their ability to meet reserve requirements, but can get the reserves later in the fed funds market at the FFR targeted by the FRB. If there aren’t any reserves there to borrow, the FFR rises and the FRB then buys securities putting them there. The money supply is primarily controlled by the extension of credit made by banks, not by the amount of reserves held on their balance sheets (Moore 1983, Pilkington 2014). The FRB eliminates shortages and surpluses of reserves in order to maintain its FFR target. A large surplus of reserves can only be held by banks under a zero interest rate policy (ZIRP) or when the FRB commits to paying interest on reserves (IOR).

**F. IMPLICATIONS**

The FRB is responsible for the monetary system, but does not completely control it; banks have a great deal of control over the creation and distribution of money in the United States. The money supply is effectively endogenous, determined by lending and borrowing decisions rather than by the FRB’s reserve operations. In addition to the normal requirements of the right-use principle governing lending decisions, i.e., that the promises made by lenders and borrowers be kept to the best of each party’s ability, banks are now clearly partly responsible for the performance of the economy through their control of access to credit. Since all money originates from loans, the “lifeblood” of the economy is governed by banks’ lending decisions, which is a tremendous responsibility.

By granting banks this power, the government appears to be obeying the principle of subsidiarity. On the other hand, loan managers making the lending decisions may not always be acting for the common good. Banks are for-profit institutions, which means banks extend credit on a for-profit basis. There may be socially necessary but unprofitable functions that are not produced because those institutions that would provide them are unable to get credit. Banks may also act in their own interest at the expense of the common good, as was widely observed in the run up to the Great
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Financial Crisis. Banks granted fraudulent loans to extract fees from their customers, sold packaged mortgages to investors in the form of complex derivatives, and then bet against those same derivatives by purchasing credit default swaps.

Furthermore, the guarantee of sufficient liquidity by the FRB creates a huge moral hazard problem where large banks may engage in reckless behavior because they know they are guaranteed cheap liquidity in the overnight market. For this reason, the FRB must regulate and supervise banks to ensure a properly functioning banking system. Its failure to do so could result in a financial crisis, much like the Great Financial Crisis. Without an elastic money supply however, the U.S. banking system is still likely to experience frequent banking crises in the form of bank runs, as was the case in the nineteenth and early twentieth centuries.

The FRB’s congressionally mandated goals of full employment and low, stable inflation coincide with the Church’s social teaching as indicated in the U.S. Bishops’ pastoral letter Economic Justice for All, though the letter does emphasize full employment over low inflation. However, monetary policy may be ineffective in securing full employment and low inflation primarily because the FRB cannot control the total level of output and spending through its interest rate policy. During periods of heavy deleveraging, the FRB’s policy of expanding reserves and lowering interest rates may not do enough to increase lending and thus stimulate demand. Provision of an elastic currency may render the FRB incapable of effecting an increase in demand using conventional expansionary monetary policy. Alternatively, it is unclear whether raising interest rates is sufficient to stem the tide of an inflationary expansion.

Monetary sovereignty, while appearing to possibly violate the principle of subsidiarity, is probably desirable and largely unavoidable for legally sovereign nations who wish to exert some control over unemployment and price stability. Abandoning monetary sovereignty would greatly restrict the power and flexibility of the government in performing its functions and meeting the goals of full employment and low inflation. However, this power can and has been abused by other governments. Imposing a gold or other standard does not remove the sovereignty, it simply adds a self-constraint. The U.S. government imposes several self-constraints including the imposition of a debt ceiling and prohibition of debt monetization by the FRB. However, these self-constraints have their pitfalls; the FRB indirectly monetizes part of the Treasury’s debt anyway through OMOs because of its commitment to target the FFR, and the debt ceiling periodically threatens the full faith and credit of the U.S. monetary system each time it is approached.
The structural setup of the U.S. monetary system is not in itself immoral or inconsistent with Catholic teaching. The United States federal government, the Federal Reserve Bank of the United States, banks, and borrowers are all responsible to varying degrees for a well-functioning and moral monetary system. In the author’s view, the greatest flaws are the potential abuse of power over access to credit by greedy or selfish bank managers, insufficient credit extended toward unprofitable but socially necessary functions, inadequate supervision or regulation of banking practices by the FRB, the moral hazard of an elastic currency, and the exploitation of monetary sovereignty by the federal government. Each can potentially be ameliorated; for example, fraud can be addressed with stronger investigation and prosecution, credit for unprofitable functions can be provided by public banks or some other form of public funding, and power can be limited by self-restraint or imposition of legal constraints. However, monetary sovereignty is necessary to pursue the goals of full employment and price stability, and an elastic currency is necessary to prevent financial crises caused by runs on banks. What matters from the perspective of Catholic Social Teaching is that those organizations, institutions, and individuals with power over the ‘life-blood’ of the economy use it rightly by acting for the common good and according to the principle of subsidiarity.

References


