

Vatican Reactions to the Financial and Debt Crises

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Close to ten years have now elapsed since the start of the U.S. financial crisis in summer 2007 and a full seven years since the start of the European debt crisis at the end of 2009. Scholarly studies of both began early on and in short order had identified the basic causes of the two. Vatican reactions came only a short time later, but paid little to no attention to the scholarly literature and as a result were wide of the mark in both their analyses and their policy recommendations.

One of the first of the scholarly studies was John Taylor's *Getting Off Track* which was published in early 2009 just as the worst of the U.S. crisis had passed. Taylor provided an excellent overview of what had gone on. With regard to the causes of the financial crisis, the book's subtitle said it all, *How Government Actions and Interventions Caused, Prolonged, and Worsened the Financial Crisis*. Here Taylor pointed to the crucial role of subprime mortgages, coupled with too expansive monetary policy in the early 2000s and inappropriate policies followed by both the Fed and the government as the crisis developed.

Anna J. Schwartz, who arguably knew more about financial crises than any other economist ever, in her blurb for the book wrote: If Milton Friedman and I had written as persuasive an analysis as this, one year rather than 30 years after the Great Depression began, the

United States might have had a typical recession rather than the greatest downturn in history.

I was editing the *Journal of International Money and Finance* (JIMF) at the time and in April 2009, two months after Taylor's book appeared, we co-sponsored a conference at Warwick University, *The Global Financial Crisis: Causes, Threats and Opportunities*. The papers presented there and subsequently published in JIMF corroborated and otherwise complemented Taylor's analysis. The article by Gerald Dwyer and Paula Tkac stands out in this regard. Dwyer and Tkac, like Taylor, identify securitized subprime mortgages as the prime movers of the financial turmoil and trace their effects throughout the rest of the fixed income market.

In July 2009, Pope Benedict XVI issued his social encyclical *Caritas in Veritate*. Only a minor part of the encyclical dealt with the crisis, but the part that did was completely off kilter. There was no mention at all of the key roles played by the Fed and the U.S. government prior to and during the crisis. Instead, it spoke of a need for regulation of the financial sector, so as to safeguard weaker parties and discourage scandalous speculation, and experimentation with new forms of finance, in the process beg-



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ging two questions—the economic function of speculation and the benefits or lack thereof of financial innovation. It went on to issue a call for a world political authority the functions of which would be [t]o manage the global economy; to revive economies hit by the crisis; to avoid any deterioration of the

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present crisis and the greater imbalances that would result; to bring about integral and timely disarmament, food security and peace; to guarantee the protection of the environment and to regulate migration. I

Then in October 2011 the Pontifical Council for Justice and Peace weighed in, issuing its letter *Towards Reforming the International Financial and Monetary Systems in the Context of Global Public Authority*. The letter has two principal concerns: the financial crisis and the

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Perhaps the financial sector is an example of what Pope Francis calls the existential outskirts of society. These are parts of society where God is apparently absent, but that doesn't mean that God despises people who

live or work there, or who face those situations. It doesn't mean either than Catholics have to stay away from those places, quite the contrary. Good men and women, who are aware of their call to serve in all human endeavors, are necessary to conquer those existential outskirts.

Our students have to be those good men and women.

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distribution of income internationally. Rather curiously it makes no mention of the European debt crisis which was by then well underway.

The letter is a rather rambling mixture of casual empirical claims, confused economic theorizing and dubious moral theology. Consider the following passage as an example:

In monetary and financial markets, however, the dynamics are quite different [from those in goods markets]. In recent decades, it was the banks that extended credit, which generated money, which in turn sought a further expansion of credit. In this way, the economic system was driven towards an inflationary spiral that inevitably encountered a limit in the risk that credit institutions could accept. They faced the ultimate danger of bankruptcy, with negative consequences for the entire economic and financial system.

In its discussion of the financial crisis, the letter is all over the place. Initially the letter alludes to the crisis having multiple causes. In a later discussion, it describes money

and credit instruments worldwide [that] have grown more rapidly than the accumulation of wealth as a cause of crises in general. It finally gets to the bottom line with its assertion that [t]he speculative bubble in real estate and the recent financial crisis have the very same origin in the excessive amount of money and the plethora of financial instruments globally. What exactly this means is, however, open to conjecture.

The letter follows up on *Caritas in Veritate* with its own call for a world political body, dubbed in rather Orwellian fashion the Authority. What makes this proposal particularly incongruous is the harmful role that government policies played in the financial crisis and in the European debt crisis that followed.

More generally there is the question of whether a policy body of such scope that had control of both monetary policy and economic policy in the broader context would have any chance at all of increasing societal welfare. History certainly is not kind to the idea and neither is theory. Friedrich Hayek in his classic *The Use of Knowledge in Society* (1945) seven decades ago explained why planned economies would fail

and the experience of both the last century and this one so far have borne him out. Why these messages have not got through to the Vatican is very hard to fathom.

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