THE ABSOLUTE STATE OF MONEY IN 2021

JEFF DEIST INTERVIEWS DR. ROBERT P. MURPHY
Do we even know what money is anymore?

After the crazed fiscal and monetary interventions of 2020, sold to the public as “stimulus” and “liquidity,” we can hardly keep up. M1, the measure of “ready” money, represented by cash and demand deposits, essentially went vertical on a graph beginning in March 2020—doubling in a year. But Jerome Powell tells us there is no connection between the Fed’s actions over the last year and the prices you see every day at the grocery or gas station.

Real interest rates are negative in the US, and nominally negative for many euro sovereign bonds. Treasurys and even certain bonds (e.g., those sold by Goldman Sachs) claim a deceptive degree of “moneyness” due to their current liquidity. And never mind the shadow banking system of giants like Quicken Loans, which (unlike central and commercial banks) at least do us the favor of operating with the Fed’s explicit backstop.

In truth we really don’t know how much money, money substitutes, and unbacked claims to money actually exist—not to mention how much government, corporate, household, and individual debt is out there, lurking.

Thus we look for clarity in unprecedented times. Perhaps nothing Mises wrote held up as well or as long as 1912’s The Theory of Money and Credit. The theory of money must take into consideration all that is implied in the functioning of several kinds of money side by side. Only where its conclusions are unlikely to be affected one way or the other, may it proceed from the assumption that a single good is employed as common medium of exchange. Elsewhere, it must take account of the simultaneous use of several media of exchange. To neglect this would be to shirk one of its most difficult tasks.

– Ludwig von Mises, The Theory of Money and Credit

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Channeling Mises, our cover interview with Dr. Robert Murphy is all about the state of money in 2021 America. Murphy wrote the study guide companion to Mises’s great work, and recently finished an incredibly valuable series of articles for the Institute on money mechanics.

These articles, which update and correct an out-of-print Fed publication called Modern Money Mechanics, expand on monetary theory by giving readers the “plumbing” behind how money operates in the modern context. Dr. Murphy gives us a succinct lesson in the history of money, how it works mechanically, money and credit creation by central banks and treasuries, applications like business cycle theory, and challenges to orthodox views. There are great individual chapters on subjects like inflation, inverted yield curves, shadow banking, modern monetary theory, and rules-based approaches to monetary policy. There is an especially important treatment of “extraordinary” monetary policy since the financial crisis of 2008. And yes, there is a concluding chapter on bitcoin.

Together, Murphy’s serialized articles form nothing less than a brilliant short course on money. We will publish them as a physical book this fall. But you can read them now at mises.org! And I know you will enjoy our far-ranging interview on all things money.

Also, don’t miss Dr. David Gordon’s review of an intriguing new foreign policy book: Andrew Bacevich’s After the Apocalypse: America’s Role in a World Transformed. The economics and financing of war has always been an important topic for Austrians, as “military Keynesianism” is alive and well. Bacevich criticizes the outsized role of American intervention overseas, but he goes a step further and questions the old conventional narratives going all the way back to World War I. We cannot understand the modern world without knowing its precedents, and the Great War—far from Woodrow Wilson’s gloss—actually served to destabilize and decivilize the West. Bacevich earns Gordon’s praise for a degree of revisionism, and for proposing a far more realistic and restrained US presence abroad. But the author falls into traps as well; America must remain the “indispensable” nation and deter aggression, yet somehow avoid a new Cold War with China. The book also sours Dr. Gordon with an approving nod to the 1619 Project’s jaundiced view of things. But any challenge to neoconservative bellicosity is welcome.

Thank you, as always, for your support of the Mises Institute and its mission.

Jeff Deist is president of the Mises Institute.
Jeff Deist: You recently completed a series of articles for the Mises Institute, which we will publish in book form, on how money works today. Why is it important for average people to understand the mechanics of the plumbing of central and commercial banks?

Bob Murphy: There’s two main reasons. First, it’s intrinsically interesting. That’s why I went into economics. Just like the average person should know the basics about physics and chemistry and Darwin’s theory of evolution, likewise, the average person needs to know: How does money work, how do banks work? Just the raw basics of it because it’s an important part of modern society, even premodern society, in terms of money. But beyond that, because central banks certainly since 2008 and even more so in the wake of the pandemic in 2020 have done lots of things that I believe are setting the world up for a series of major financial crises, and the average person needs to know about this.

JD: Considering the monetary and fiscal machinations engaged in by governments since the pandemic, it’s as though we lost any
sense of what money is. It seems unlimited. People on Twitter tell us money is just information, or energy in a system.

**BM:** I do know what you’re saying. On the one hand, I can’t bristle too much when outsiders, people like Eric Weinstein, come forward and they say the economists have just botched it. I get why they’re saying it, because the economists have done such a poor job. It’s hard for me to say hey, stay in your lane, leave money to the economists. But, on the other hand, you’re right. We shouldn’t jump to the conclusion that the older-school economists and the ones in the Austrian tradition don’t know anything and that there’s no point in reading them. There are lots of fallacies that intelligent people who are not conversant with the economics literature might fall prey to, just like if you go into philosophy, there are lots of detours, and you would do well to take a basic course in philosophy to avoid fallacies that plagued people centuries ago. Likewise with money, there are lots of ways you can go down the wrong path, and some of these bright people who are spouting off on Twitter are just going over stuff that was demolished by Mises in 1912. They’re just repeating those fallacies and it’s because they never heard of it before.

**JD:** To be fair, the average Joe or Jane might well say money is just this made-up thing government tells us to use.

**BM:** Exactly, and it’s interesting because there is this sense in which money is a social convention, but it’s not merely a social convention. Just like spoken language is a social convention in a sense but that doesn’t mean words can just mean whatever you want. Money is a complex topic and it is easy to think of money incorrectly and certainly to then endorse government policies that would be disastrous because you don’t really understand exactly what money is or how it functions.
JD: We've heard two words ad nauseam over the past sixteen months: stimulus and liquidity. One is fiscal, one is monetary. Executives, Treasury officials, legislatures, and central bankers all throwing everything but the kitchen sink at the problem. Are fiscal and monetary policy effectively merging?

BM: I think you're right that part of what’s been happening is the traditional divide between fiscal and monetary actions has been blurred. For example, during the Obama administration (this is back when this was shocking) there were four years in a row in which the federal deficit was higher than a trillion dollars. And that was also roughly when the Federal Reserve, implementing its independent monetary policy, with no concern about the budget needs of the government, was engaged in these rounds of QE (quantitative easing). And at the time, I didn't think that was a coincidence, just like now I don't think it's a coincidence that the federal government is running massive deficits right when the Fed keeps adding to its balance sheet and buying Treasurys. I don't think that's a coincidence.

So yes, there is this merging. Then you’ve got MMT (modern monetary theory), for example, which quite explicitly just consolidates everything. They say that when the federal government runs a deficit and buys fighter jets, the Treasury instructs the Fed to mark up the checking account balances of Northrop Grumman or Lockheed Martin, or whoever makes them. I think that’s wrong. There are still some legal issues involved, and technically the Treasury can’t just spend whatever it wants and tell the Fed, “Mark up the checking account.” Legally speaking, that’s not how it works. But you’re right, conceptually that’s the way a lot of people, even with PhDs in economics, are starting to talk about it, so it is blending together.

There are some senses in which that approach is probably correct: like I said, it was naïve for mainstream economists to act as if what the Bernanke Fed did during the Obama years was purely because they were targeting CPI (Consumer Price Index) and doing it not because they knew, the feds are issuing this much debt; if we don’t want interest rates going up on Treasurys, we have to buy a bunch of them. And at the time, I didn't think that was a coincidence, just like now I don't think it's a coincidence that the federal government is running massive deficits right when the Fed keeps adding to its balance sheet and buying Treasurys. I don't think that's a coincidence.
JD: Give us your quintessentially fair and objective description of MMT, along with your critique.

BM: What’s funny is I’ve actually formally debated Warren Mosler. If you jump into YouTube and look at the comments, they’ll say, “Oh, Murphy agrees MMT is correct, he just doesn’t like it.” It’s a very seductive approach they have where they’re casting themselves as saying, “Look, we’re not passing judgment, we’re just saying this is modern monetary, this is the way the modern financial banking system, government money system, works, take it or leave it, and you need to know this.” But at the same time, I don’t know of any MMT proponents who want the US government to return to its constitutional duties. It seems that the MMT sort of neutral, positive as opposed to normative description of how the world works almost always goes hand in hand with prescriptions for a massive expansion in government entitlements and other types of spending programs, intervention and healthcare, because they think they’ve shown we don’t need to worry about debt.

And, just to circle back, what do they do? They’re saying, unlike private sector individuals or corporations who have to use the money but are not sovereign issuers, the monetary authorities, the US government or the Japanese government, they have monetary sovereignty. They can issue their own currency. They don’t have to pledge to redeem it in some other currency. It’s not tied to anything.

After 1971, the US dollar is not redeemable in anything. It just is what it is, it’s its own commodity unto itself, there’s no actual constraint on the US government spending more money. And so they say, if we’re talking about if we should have Medicare for all, stop saying, “How are we going to pay for it?” I think that’s the fundamental point of the MMT crowd and I'm not putting words in their mouths. Stephanie Kelton, one of the major proponents right now, that’s how she talks. And so then you say, “Okay, there’s a sense in which that’s correct, but there’s also a sense in which that’s extremely dangerous and misleading.”

So yes, it is true, if the federal government wants to fund another moon shot, wants to put a base on Mars, wants to guarantee everybody’s healthcare and that’s going to cost $20 trillion in current prices, they could go ahead and just create that money. There’s nothing legally stopping them. But to me that’s a very dangerous thing to tell the public, because it leads them to believe they can do it without any bad consequences, when in fact, I would argue, doing that’s going to raise the dollar prices of goods and services. You’re not creating extra real resources just by creating dollars. Under a gold standard, for example, everybody would agree, it’s too expensive, it’s not worth it to try to build a Mars base any time soon. By freeing the Federal Reserve from the fetters of gold, you don’t all of a sudden give us better technology. You don’t all of a sudden make more space-ships available or bases that are half built on Mars. It’s

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you want to risk going to prison if you hold up the convenience store?

That’s what the MMT people bring to the table when they say, “Let’s stop saying we can’t afford Medicare or is the public willing to tolerate higher taxes, because we can just print the money.” You’re not helping anything and in fact, you’re just dangerously leading people to believe this is some financing mechanism that actually you would never want to endorse.

JD: In the MMT conception, when Uncle Sam creates debt—public debt—that debt is private wealth.

BM: Great point and you’re right, that’s another pillar of MMT, at least about how they talk to the public and flip around your thinking about everything you’ve heard about government finance.

JD: Like deficits.

BM: Yes. That’s another sacred cow they’ll tackle. And let me be clear, I understand why so many people have become enamored with MMT, and especially Stephanie Kelton’s latest book, The Deficit Myth: Modern Monetary Theory and the Birth of the People’s Economy, is provocative as well. She’s a funny writer, and I can see how someone who’s willing to go down that path can read her book and say, “This is great.” Specifically what they’ll say is, “Don’t listen to these budget hawks, who say let’s stop passing the buck to our grandkids. If you think about it from an accounting perspective, the only way the private sector can accumulate net financial assets is if the government goes deeper into debt.”

The way they’re thinking about it is: if my pension fund accumulates corporate bonds, my pension fund might have more assets, but then that means the corporation that issues those bonds now has that extra liability, so on net, those members of the private sector just cancel out. They’re saying the only way the private sector as a whole can have claims on some entity that
doesn’t internally cancel out is if the entity is a non-private sector group like, oh, the US federal government. If the private sector accumulates Treasurys, stop looking at it as, Uncle Sam’s deeper in debt, how are we going to pay for this as taxpayers? Instead, look at it as, we now have many more assets, look at all these extra Treasurys we have. That’s the argument they use and I think there’s a sense in which it’s correct in terms of the accounting.

I actually think it’s not right because you could have equity. If someone starts a corporation and then people have shares of that and it’s a productive enterprise, your share price doesn’t correspond to somebody’s debit somewhere. Even on its own terms, that’s actually not correct. But even if it were correct, it still is misleading because you could just as well say, “The way that the world minus the Mises Institute gains net financial assets is the Mises Institute goes deeper into debt.” That’s also true in terms of the accounting. It’s misleading, especially when it comes to government bonds: the way we as a private sector get paid what we’re owed on those “net financial assets” is the government points guns at us, takes money, and then hands it right back to us and says, “Here’s the payment on your Treasurys, thank you.” There’s no sense in which we should view that as some asset that’s exogenous that makes the private sector wealthy.

**JD:** I’ll play devil’s advocate. To be fair to MMTers, in 2020 the US federal government borrowed about half of what it spent and the sky didn’t fall. And Professor Stephanie Kelton, the current face of MMT, is not nearly as odious as Krugman or some of our Keynesian friends.

**BM:** Right.

**JD:** If MMTers tend to hold left-wing political views and support big government, their retort would be that Austrians tend toward libertarian views—so our theory is just as “political.” And the idea that a sovereign issuer of currency can spend unlimited money, well you can see the enormous seductive appeal.

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**BM:** Yes, Austrian economists stress that Austrian economics is positive, it’s not normative, and yet, in practice, very few people study Austrian economics and say, “Yes, now that I know how the business cycle works...” that’s possible. So, point well taken there. I also agree with you that Warren Mosler is a charming guy. When I debated him years ago, we were chatting before the debate and he was so charming and friendly that I realized I needed to step away, otherwise I was going to be a softie in this debate. The MMTers can say, “But regarding the issue of you right-wingers, not just the Austrians, but the Glenn Beck and Bill O’Reilly types of the world were warning since 2008, look what the Federal Reserve is doing and the dollar is going to crash. Some people were even using terms like hyperinflation, talking about the Weimar Republic and wheelbarrows. None of that happened, so how long are you guys going to continue to be wrong, talking like that?” I would say, on the one hand, yes, that’s a reason people should be careful and not throw out wild predictions, and I myself have made some predictions that turned out wrong and then I have to bear the brunt of that.

But, beyond that, if we are in an environment where the demand to hold money goes up, prices would have come down. Part of the problem is that people who had savings, they would have seen those savings having much more purchasing power than they do today. It’s really an issue of it’s a counterfactual relative to what otherwise would have happened. It still is true that by the Fed creating such and such more dollars, the purchasing power of the dollar is lower than it otherwise would have been, even though yes, measured in
absolute terms, gasoline is not $20 a gallon right now. It’s also true too that by the Fed creating this money, it’s redirecting resources in the political channels.

Let’s use an analogy. If you found out your neighbor down the street was using his color printer to print out authentic-looking $100 bills, he’s been doing it for years, and that’s how he has nice cars. That’s how he goes on these vacations he’s telling you about. That’s how he can afford to dress impeccably. It would be silly for him to exonerate himself and say, “Did the economy crash, is gasoline $20? No, so stop blaming me; you can see nothing bad happened.” That wouldn’t be the issue, right? Can you understand why in that context, it’s the same thing economically? Just as I wouldn’t want my neighbor to have that ability, I don’t want Federal Reserve officials to have that ability either.

JD: Let’s talk about interest rates. Since 2008 and this period of extraordinary monetary policy, really since the Greenspan era, interest rates have been driven relentlessly lower. We’re now in a bizarro world where maybe a third of European sovereign debt is nominally negative. Nobody can make any money on a CD or simple savings account. What the hell is going on with interest rates?

BM: This is an area too where the economists have egg on their faces and I don’t just mean Austrian or conservative ones. Even Paul Krugman. They were matter-of-factly explaining: Nominal interest rates can’t go below zero because people would just switch to holding cash and that’s why once the Fed’s policy rate gets close to zero, we need to switch to other unconventional things or have deficit spending. The negative nominal interest rates shocked a lot of economists across the spectrum, because they had been teaching their students for years that it was literally impossible and then once it happened, the economists had to scratch around and say. That’s because in large institutions, to actually hold that much cash, you’d have to insure it and what are you going to do, put it in a safe deposit box? Once the impossible happens, economists are good at after the fact explaining why it happened and criticizing people who have, in their view, silly explanations.

But, it’s not that I saw negative nominal interest rates coming. I certainly think central banks have a lot to do with it, so to the people who argue to the contrary
and say, “No, the Fed and ECB (European Central Bank) are just following the market down,” well, in one sense I want to say: then you should have no objection to the Fed and the ECB just liquidating their holdings and selling their assets, right? Because according to you, that’s not going to make interest rates go up. And usually they say, “No, that would make interest rates go up and that would crash everything. That would be a crazy policy to have such a restriction.” Usually when you push that they will admit yes, central banks and their policies have had something to do with lower interest rates. One of the points of QE was to lower long-term rates, because they were saying short-term rates went down to zero. Basically, that wasn’t enough, so now the Fed needs to intervene and try to push down long-term rates in order to stimulate spending, from a Keynesian perspective. Even the people pushing these things do admit, either explicitly or implicitly, the low nominal interest rates at least have something to do with massive central bank action.

Partly why it’s happened is people are so panicked. That right now, there’s such uncertainty and desire for perceived safety that people are willing to just sit on earning basically nothing with government debt. Especially if it’s from the US or the Japanese government, that’s perceived as being very safe in terms of they’re not going to default on the bond, even if they’re earning nothing or even if they’re earning slightly negative—even in nominal terms. But that’s not a natural evolution of capital. That’s not because the Chinese are saving so much. That’s because there have been these crazy business cycle swings, which, in the Austrian perspective, is because of massive central bank intervention. Ultimately, I would say it’s the central banks and their policies that have led us to this position, directly because they’re monetizing debt and pushing down interest rates and indirectly because they’ve caused the massive uncertainty that’s causing people to be so fearful that they want to have huge holdings in ostensibly safe assets.

JD: You mentioned some economists who say “Central banks don’t much matter; this trend was happening anyway.” But people like former Fed chair (now Treasury secretary) Janet Yellen also warn there are limits to monetary policy. The term is pushing on a string. There’s only so much monetary policy can do. What have these ultralow interest rates done for us?

BM: I agree that the ultralow interest rates have not done anything benign or good for us, that they present a problem. Somebody from a Yellen perspective or a Paul Krugman, what they mean when they talk like that is to say, “We can go ahead and push down interest rates, like I say, down to basically 0 percent and then we can engage in QE, even, and try to raise inflationary expectations in the future.” And the reason for doing that is to lower the real interest rate. So they’re saying once nominal rates get to zero (and yeah, they actually could go slightly negative, but they couldn’t go to –10 percent in nominal terms; even money market funds
would switch to hold cash), how do you lower the real interest rate? You’ve got to raise expectations of future price inflation so that in real terms even a 0 percent nominal rate translates into –10 percent.

But, they’re coming from a Keynesian perspective when they talk like that. They think what you want to do is make people want to consume or invest now and the way you do that is you lower real interest rates. That’s the framework that they’re in and as an Austrian, I would say that that’s wrong, that interest rates have a job to do. They communicate information, if you want to use that language, and it means something. If the interest rate in the market would be 4 percent and instead it’s been pushed to zero, that’s going to screw things up. It causes the boom-bust cycle. As far as Yellen, especially now that she’s Treasury secretary, what they’re trying to get at is, there’s only so much the central bank can do. Once we’ve done all that and we’ve run out of ammo, it’s up to the fiscal policy to go ahead and run big budget deficits. So again, I think that’s totally wrong, what they’re saying, but that’s what they mean, because in their framework, what you do is you lower interest rates to stimulate spending, to fill aggregate demand. They’ve lowered interest rates, all right, and we’re still in a bad economy, so you can see how from their perspective, let’s try something else, then.

JD: Maybe it’s a political deflection on her part. But conceptually, axiomatically, we know nobody would loan you $100,000 today in exchange for a payment of $90,000 two years from now. Interest rates are supposed to be positive.

BM: Right. One way of putting it is look at the extraordinary circumstances that had to exist to explain why the Bank of Japan and maybe the ECB were considering this scenario. If you keep money on deposit with us and then you pull it out, they’re going to then charge you interest retroactively. I’m making these numbers up, but if they wanted to have a –10 percent rate and you pull out half your money, then they would actually ding the remainder that you left on deposit double that, so that you’re not gaining by pulling money out of the system. I’ve seen plans in place, I think it was in Japan, to avoid precisely that. That, if we wanted, if our policy rate were to be excessively negative in nominal terms, such that everybody would switch to holding physical currency, we’re going to set things up to ding you for that, to look at what your historical balance has been over the last five years to make it so that you don’t have the incentive to do that. They are setting that up so that they can get away with doing that, and that’s partly why there’s this push to get rid of cash, because that’s ultimately the way to protect yourself. I can hold a currency and earn zero percent in nominal terms in a safe in my house and so if they can get rid of currency so it’s all electronic, then you can’t even do that. You’re right, thinking through the logic of it in normal circumstances, why wouldn’t you just hold actual money if the banking system’s paying you negative nominal rates? There is a sense of that’s crazy and it can’t be a normal outcome.

JD: As an aside, it’s pretty remarkable how Mises’s Theory of Money and Credit from 1912 has held up. If you want to understand interest rates, go read that book.

BM: As you know, a few years ago the Mises Institute commissioned me to produce a study guide for that book. I had to reread it and sort of the old joke about when I was younger my dad was an idiot and then I grew up and I realized how much smarter he had become or wise. It was the same sort of thing—I had
read it in grad school, and then having read it years later
to do the study guide, I realized, Mises just has offhand
remarks about all sorts of things like forex specula-
tion and derivatives markets, and things like that, calls
and puts, I think. It is interesting to see how much he
really was a great financial economist. He understood
modern money and banking and financial markets of
his day and handled them as a brilliant theorist.

JD: There’s a lot of mainstream talk today about
inflation. I wonder if that’s another concept, another
term, where we have lost any agreed-upon definition.

BM: Right. Mises, famously, complained about—
this was like the midcentury in terms of the US—he
complained to an American audience saying how it
used to be in the early 1900s, that everybody knew
what inflation meant, it was an expansion of the quan-
tity of money stock and/or the credit that the banks
made available. And so, inflation had the inevitable con-
sequence that prices quoted would go up, but inflation
meant—just picture inflating something—a quantity of
money would be inflated. That’s where the term came
from, and he said, but now, over the decades, it has
been changed—and again, he’s speaking in the 1950s—
what the public thinks inflation means is rising prices.
And that’s unfortunate, he said, because it’s now mis-
taking the symptom for the cause, and you can’t fight
it if what you think the thing is is actually just a symp-
tom. He said we have this perverse situation where the
people causing the inflation are posing as the people
protecting the public from inflation, which is crazy.

Since 2008, with all the massive monetary inflation
that we’ve seen and with the rise of the internet and
financial commentary by people outside the accepted
gatekeepers, there’s been a resurgence and interest in
that definition. Nowadays more people understand this
huge expansion of the monetary base and look at the
Fed’s balance sheet, look at all this inflation, and yes,
it hasn’t shown up yet in prices at the grocery store
necessarily, but look at all this inflation that’s now been
pumped into the system. A lot of “regular people” who
are not ideological and not steeped in the Austrian
school understand that sort of language, and so we’re
seeing a return to that.

But you’re right, there’s not an agreement on what
does inflation mean and even in terms of looking at
prices, the standard definition, it’s a very narrow basket
of consumer goods. What if stock prices triple? Why
isn’t that considered inflation, especially if the reason
they went up is because the Fed created a bunch of
money? What if real estate prices go up? People have to
buy houses. It’s weird distinctions that they’re making:
whereas the rental price, how much you have to pay to
rent an apartment, can go into the cost of living index
but if the price of a regular house goes from $200,000
to $400,000, that’s not considered that the cost of living
has gone up, or at least it’s not that per se. You’d have to
these redefinitions of things. Whether you’re looking at headlines, CPI, or even core CPI or personal, depending on each one, it’s going back ten, twenty years, and it’s the highest it’s been in thirty years. And it’s way above the Fed’s own stated target—and it’s funny, the headlines say things like, “Powell Sticks to the Script on Inflation,” like they’re not saying it as a conspiracy. I’m not saying Zero Hedge, I’m saying CNBC. The way they describe it is Powell’s got his script and he knows: Right now our position is inflation’s not a big deal. And so even though, according to their own metrics, it’s finally bouncing above what they’re saying the target is, we’re not going to tighten, because we think it’s transitory.

You’re right, they’re going to keep doing this until it’s so calamitous that even they can’t pretend that this is just a temporary blip. We’ve seen used car prices up over 50 percent year over year. They’re going to be able to blame it on the pandemic and just say, “No, that’s because of supply chains.” But eventually, you keep seeing numbers like this, they’re going to have to deal with them and at least make it look like they’re tightening. But they’ve painted themselves into a corner, like you say, now, financial markets are utterly dependent on the Fed being willing to come in and buy $50 billion plus of assets per month. The Fed needs to stop doing that because even they can’t ignore the warning signs in terms of standard prices that households face, then you’re going to have another major financial crisis.

JD: It is not just banks who are dependent on low rates, but also Congress itself. If average Treasury rates rose to historical averages, say 5 to 8 percent, debt service quickly becomes the single biggest federal budget item every year.

BM: Right, exactly. At Mises University, I had a chart in my talk recently just showing the metrics of the CBO (Congressional Budget Office)—as they describe it, the nonpartisan CBO. And they’re pretty good.

JD: Yes.
BM: I said that as if it was ironic, but no, even some of them would email me about things, areas like climate change and economics, when they were doing carbon taxes. So, yes, they want to at least be fair, or at least the people who were running it the last ten years that I've interacted with. But they'll have charts of the US debt as a fraction of GDP. In the forecast, I'll show it just going up and up and up, and that's because, number one, you have demographic shifts, in terms of Medicare and Medicaid. You also have interest rates rising just a few percentage points, back to not even historic levels, but 1980s levels, even 2005 levels—then debt would be devastating in terms of the annual cost of servicing it, because there's so much more outstanding nominal Treasury debt now compared to ten years ago. The reason it doesn't feel so painful is because the yields on those Treasurys have been close to zero. And, that's why you can get away with issuing trillions more in debt. But if those numbers go up, you're right. If the Fed were in a position to maintain sanity in terms of purchasing power and to stop the runaway spiral in price inflation they were supposed to jack interest rates up to 8 percent; that would cripple the financial integrity of the US government. They are painting themselves into a corner where my guess is they're going to do a little bit of both—let the dollar lose a lot of its value vis-à-vis other currencies and have the federal government's finances get really hammered where we can pay for some of the entitlements and servicing the debt and that's about it.

JD: We worry a lot about what Congress is doing and spending. We worry a lot about what the Fed's doing. We worry about commercial banks responding to what the Fed's doing. But in your forthcoming book you have an entire chapter devoted to shadow banking—carried out by nonbank lenders. What is shadow banking and should we be concerned about it?

BM: The term, as it suggests, is transactions happening in the shadows. These transactions, they serve the same economic function as traditional bank lending, but don’t operate through formal banks. If there’s any kind of private entity that raises capital and then goes around and funds ventures and things like that, that’s a way of ultimately linking savers and borrowers in a nexus that falls outside the traditional banking sector. Broadly speaking, that’s what shadow banking refers to.

The conventional reason, by the standard establishment types, they’re saying, After the 2008 crisis, we had Dodd-Frank (Dodd-Frank Wall Street Reform and Consumer Protection Act) and we can beef up the SEC (Securities and Exchange Commission). The Federal Reserve can go ahead and beef up regulations all they want, but that’s really clamping down on traditional banks. They look at investment banks, but that just pushes more people into the shadow banking sector, where we can’t regulate. So they use it as calls to have broader regulation and whatnot.

**The Fed needs to stop printing because even they can’t ignore the warning signs in terms of standard prices that households face.**
From my perspective, it is concerning because by its very nature, it’s hard to quantify this because it’s all kinds of things that don’t get reported on by the main government statisticians, and it’s hard to get data on this, but certainly those types of financing mechanisms have become more prevalent. The problem is, for example, that an institution, they owe people a bunch of money, but they’re saying, These other people owe us money. And so, those webs get pyramided on top of each other. That shows how if there’s a crisis in one area, they can all of a sudden have this domino effect elsewhere. You partly saw that in the 2008 crisis, that it wasn’t the fall in mortgages per se that caused the problem, it was the people that had put out things that would make you whole if your mortgages went down and that was even just a margin call. So, these were the chain reactions that made the mortgage-backed securities markets seize up.

That’s the concern that I have: there’s a sense in which the financial sector globally is intertwined and people are engaged in a lot more leverage, and even conventional metrics might miss some of this, and if a crisis breaks out even in one localized area, that could quickly spread, because people don’t fully realize how vulnerable the whole system is.

**JD:** How much off-balance-sheet debt is out there? Maybe there are trillions of dollars in exposures which don’t show up in our traditional measures of sovereign, corporate, household, or individual debt.

**BM:** I think that’s true. When I was doing research for the chapter you’re talking about in the book, it was surprisingly hard to pin down. I can see studies that look at this chart, but the problem was that they each had their idiosyncratic definitions as to what are we including in this metric.

**JD:** How much debt is in the world?

**BM:** If I have a $200 tab at my local bar, does that get counted? There’s lots of things like that that are more formalized, of course, but it’s ultimately how much do people think other people owe them, and there are different degrees of legality. Then who are you reporting that to? It’s not as easy to measure as how much outstanding Treasury debt is there.

What about what the federal government implicitly has promised current workers? When you retire, we owe you these benefits of social security. Well, that’s not a legally enforceable claim, but yet usually that gets counted in terms of the federal government’s liabilities, broadly considered. You’re right that there’s these different levels. Or if privately held companies have understandings with others, they could be formal contracts, but if nobody has access to that because they want to keep this secret, there could be all sorts of debt claims people hold against each other that aren’t showing up in our statistics.

And to the extent that there’s more regulation reporting requirements and there’s less privacy in the official channels, that’s made people go more underground, and especially with crypto, it’s becoming easier and easier for people to deal with each other financially in ways that do not show up in the public ledger. It’s true that these claims have grown, but by their very nature, it’s hard to quantify that. So how much? I don’t know because that’s kind of what we’re talking about; it’s in the shadows.

**JD:** It’s not always shadowy. Maybe the biggest non-bank lender in the United States is Quicken Loans, but we don’t think of them as nefarious. And they might seek out a political bailout from Congress if housing markets go south, but unlike commercial banks they
can't go to the Fed and get dollar reserves for their junk assets.

**BM:** Right.

**JD:** So maybe we should champion them.

**BM:** I use the term *shadow banks* just because that's the term that's thrown around, but you're right. Like I said, a lot of times when you hear people discuss this, it's from the perspective of people who don't trust it. Unless the SEC and the Fed are involved, we can't trust this. So, you're right, it's in the shadows should not be taken to mean there's something illicit about it. I am in favor of financial transactions that are more just person to person and entity to entity and the government's not involved. Unfortunately, though, like you said, the Fed has expanded the sorts of activities that it can dabble in, and that does mean that the bigger the sector, the more that people could argue these groups are too big to fail. Until the point at which the dollar starts really crashing, why wouldn't the Fed come in and buy that up and rehabilitate that market?

**JD:** I want to finish by talking about bitcoin. You wrote *Understanding Bitcoin: The Liberty Lover's Guide to the Mechanics and Economics of Crypto-currencies* in 2015. What prompted you to write that book, and have your thoughts on bitcoin changed or evolved?

**BM:** I want to mention my coauthor, Silas Barta. He was a person who had an early mining rig before I even understood what that term meant. He was into bitcoin and he helped in terms of the math.

**JD:** He's currently filthy rich on a private island somewhere?

**BM:** I don't know. I know he can pick and choose when he works, but I don't know how much he actually held. Why I wrote the book, to answer your question, when bitcoin first came out, people were telling me about it, and I looked into it and did a lot of research. It's a cool thing. I wasn't into it so much at the beginning. As I got more and more into it I could see there was a group of people who knew about economic theory, monetary theory, and there was a group of people
who understood public and private key encryption and Satoshi’s white paper, and there was very little overlap between those two groups. The monetary economists were talking about bitcoin in ways that were not right because the bitcoin community was saying, “No, you’re making false statements about how bitcoin works.” But then at the same time, the people who knew how bitcoin worked in terms of the mechanics of it would then say, “It’s the money right now and it’s the best currency,” and the economists would say, “No, that’s not how money works. You’re talking about money improperly.” That was the rationale for the book I wrote with Silas Barta, to give a framework. This is how bitcoin works mechanically and then in terms of how you would place this inside standard monetary theory in the Austrian tradition. This is how you would do it. I was just trying to clarify the terminology so those two groups could talk to each other and not make the other think they were idiots because they were making a basic mistake in nomenclature.

**JD:** Do you view bitcoin differently today? Seven years in bitcoin time is like seven hundred.

**BM:** Exactly. We were very careful in that book to say over and over we’re not telling you to invest and this isn’t saying it’s a good speculative asset. We are not talking about whether, measured in dollars or some other currency, bitcoin’s going to go up or down. We’re just explaining to you the mechanics of it. That was partly to make sure it wasn’t construed as investment advice, but also it was because I was more agnostic at the time.

Having seen it continue to grow, having seen massive price dips and people numerous times go, “Bitcoin’s dead, told you so,” and then it comes back and hits new highs. I now am comfortable saying in the year 2100, for example, people will still be checking the bitcoin blockchain. Some of it will be lost—people lose their private keys—and people will still know who holds it. I don’t necessarily think it will be a huge player in international commerce. It might be something akin to having big bars of gold right now, in that people know who owns them, but it’s not that those gold bars right now are the centerpiece of global transactions.

I’m not saying bitcoin is going to still be the primary cryptocurrency, but I do think people will hold it, whereas probably back when we wrote that guide I would not have been so comfortable saying that. I’ve seen enough now with the explosion of market caps and various types of cryptos to think that it is here to stay. It’s not that crypto’s going to disappear in ten years and people are going to look at that as a fad. That’s my view at the moment, and probably I’m more comfortable saying that now than I would have been back in 2015.

**JD:** Final question. What is the endgame? Does the US dollar get unseated in our lifetimes? How does all of this debt and monetization come to an end?

**BM:** I think it was Jim Rogers who said that the nineteenth century was the British century, the twentieth was the American, and the twenty-first is going to be the Chinese century, and I think that’s true. Given what they’re doing with the dollar, the only thing that’s going to make Federal Reserve officials pull back on how many dollars they’re creating is a massive crisis. Once that happens, they will be chastened, and maybe they’ll save some face, but I don’t think the dollar is going to reemerge as the global world’s reserve currency, with
the prestige it had circa 1965. I don’t think that’s going to happen partly because the US’s prestige on the world stage is shrinking in many metrics and what the Fed’s been doing has been very irresponsible. It’s been coasting on its reputation.

If a South American government’s central bank had done the things the Fed has been doing, their currency would have crashed long ago. Speculators would have dumped it, saying this is reckless. The Fed gets away with it because people think, Come on, this is the Americans. They can’t be that foolish. Surely, if things start to get out of hand, they would quickly reverse course, and with what they’ve done now, that’s not going to be possible. That’s a long way of answering your question. Thirty years from now, I think the US in general is going to be a much smaller player in global affairs. There might be a basket of currencies that the IMF (International Monetary Fund) discusses, with SDRs (special drawing rights), or the World Bank, and the dollar still might be a big component of that. But in terms of is the dollar going to be viewed as the world’s reserve currency, no. In thirty years, I don’t think people will talk like that at all.

JD: Thanks very much, Bob Murphy.

BM: Thanks, Jeff.

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Your Generous Legacy Gifts Are Important to Us and They Deny the Feds Your Hard-Earned Wealth
Andrew Bacevich, a history professor at Boston University for twenty-three years, has written an excellent book on American foreign policy, but it is embedded within a larger and more questionable book. Fortunately, the merits of the former book outweigh the problems of the latter.

Bacevich tells us that “cumulative policy failures ought to have made it clear that a national security paradigm centered on military supremacy, global power projection, decades-old formal alliances, and wars that never seemed to end was at best obsolete, if not itself a principal source of self-inflicted wounds. The costs, approximating a trillion dollars annually, were too high. The outcomes, ranging from disappointing to abysmal, have come nowhere near to making good on promises issued from the White House, the State Department, or the Pentagon and repeated in the echo chamber of the establishment media.”

As will already be clear, Bacevich writes with moral passion, and he has modeled his book on a work expressing similar passion written eighty years ago, Strange Defeat. In that book, the great French medievalist Marc Bloch indicted the French military and political leadership of the 1930s for the failures that led to the collapse of France before the German onslaught in 1940. “My purpose in writing After the Apocalypse compares
with Bloch’s. In books and essays published over the past twenty years, I have called attention to various failures of American leadership, particularly related to this country’s recurring misuse of military power. … Like Bloch, I make no pretense of dispassion.”

Bacevich’s indictment of American foreign policy is far reaching. Under the guise of what he calls American exceptionalism, we have sought to impose our will on the world. “[R]edefining the nation’s role in the world will remain all but impossible until Americans themselves abandon the conceit that the United States is history’s chosen agent…”

The illusion of American exceptionalism has had bad consequences. Among these, “and most troubling of all, is U.S. involvement in the intentional killing of noncombatants, which is always wrong and can never be justified by ‘military necessity.’ … Targeting civilians became a central component of the American way of war … we can no more tabulate how many civilians were killed by made-in-the-USA fragmentation, incendiary, cluster, or atomic munitions since the 1940s than we can calculate the number of people who died during the Stalinist purges of the 1930s or the Cultural Revolution that Mao Zedong launched in the mid-1960s. All we can say for certain is that the death toll exacted by U.S. bombing was massive and correlated imperfectly at best with intended political outcomes.”

Even if one were to put morality aside, Bacevich says, we need to ask “the most fundamental of questions: Does the United States possess the military wherewithal to oblige adversaries to endorse its claim of being history’s indispensable nation? And if the answer is no, as the post-9/11 wars in Afghanistan and Iraq suggest, wouldn’t it make sense for Washington to temper its ambitions accordingly?”

And it is clear that America does not possess the military wherewithal to continue to rule the world: we are over-committed. “Here we arrive at the abiding, unspoken premise of basic U.S. policy, spanning both the Cold War and all the years since: the conviction that containing or deterring or coercing nation-states that are both far away and classified as dangerous holds the key to keeping Americans safe at home and guaranteeing their freedom … On occasion the United States has found itself face-to-face with threats that did not conform to the profile of Pentagon-preferred adversaries. On each such occasion,

Under the guise of what he calls American exceptionalism, we have sought to impose our will on the world.
with the American people gripped by fear, the existing natural security paradigm was found wanting.”

It is a great strength of Bacevich’s book that he brings into question the entire conventional narrative of American foreign policy in the twentieth century. He says about World War I: “The United States went off to fight, Woodrow Wilson declared, ‘for the ultimate peace of the world and for the liberation of its peoples,’ a stirring vision considerably at odds with the actual war aims of the belligerents on both sides. Alas, the war brought neither permanent peace nor liberation. No sooner did it end than Americans began having second thoughts. Revisionist historians like Harry Elmer Barnes, eventually joined by Charles A. Beard—among historians of his day an acknowledged superstar—argued that U.S. entry into the Great War had been a huge blunder.”

In another fine passage, Bacevich says, “Here, in a nutshell, is the narrative that props up American exceptionalism: the conviction that a succession of victories, engineered by the United States, had ‘created the free world,’ thereby weaving past, present, and future into a single seamless garment. That this narrative cannot withstand even minimally critical scrutiny is beside the point. (Does the outcome of World War I qualify as a victory or did it pave the way for something worse? And didn’t Soviet leader Josef Stalin, neither democratic nor liberal, somehow figure in defeating fascism in World War II?)”

It is a sign of Bacevich’s courage that he is willing to cite Barnes, a leading American public intellectual in the 1920s and 1930s but now viewed by our Orwellian guardians of public orthodoxy as beyond the pale. He also merits praise for his succinct characterization of Arthur Schlesinger Jr., as “the influential historian-political operative.”

That said, one must with regret note that there are limits to Bacevich’s revisionism. He nowhere says that the revisionists are correct, but confines himself to bringing their position to our attention. It is unclear whether he thinks the whole course of American twentieth-century foreign policy a mistake or, instead, thinks that America had the resources in the years following World War II to pursue the policy of global dominance but now no longer does so.

Further, his proposals for a new foreign policy are not all one could wish for. On the one hand, he wants to halt our “special relationships” with Britain and Israel and to bring NATO to an end; but, on the other hand, he calls for continued American presence in East Asia. “The case of East Asia differs: Under a strategy of sustainable self-sufficiency, the United States should continue to maintain a military presence there. Here, once more, the axiom: ‘First, do no harm’ applies. The rise of China and provocations by the Chinese government have caused unease throughout the region. A potential new Cold War centered on Asia looms. The possibility of an actual shooting war cannot be excluded. An abrupt change in the U.S. military posture in the Indo-Pacific could trigger such a disaster.” Is this not an example of the very Cold War logic of the need for America, the “indispensable nation,” to deter foreign “aggression” which Bacevich for much of the book brings into question?

Our confidence in him cannot increase when we find him praising that inveterate Anglophile and Cold Warrior Reinhold Niebuhr as a guide we would do well to follow. “How might Niebuhr’s emphasis on self-awareness, humility, and prudence—his advocacy of realism combined with moral responsibility—find application in the Next Order that now beckons? The chapters that follow will explore
the application of Niebuhrian moral realism to specific challenges awaiting the United States as it leaves the New Order behind.” One must say, against Bacevich, that though Niebuhr was indeed an important thinker worthy of study, he in the end provided no genuine alternative to the policy of American global dominance. Instead, he replaced the magniloquent rhetoric of Woodrow Wilson and his acolytes with the language of original sin. The upshot was that, regrettably, we must do moral wrong but be aware of our pretensions in doing so. I venture to suggest that Bacevich would find a better guide here in Niebuhr’s less bellicose brother, H. Richard Niebuhr.

At the outset, I said that Bacevich’s good book on foreign policy was embedded within a larger and more questionable book. We can best approach this other book by asking, why does Bacevich believe the apocalypse is at hand? I regret to say that the “catastrophes” he has in mind are familiar leftist bromides. We must spend less on our military establishment, he avers, so we can confront the menaces of climate change and covid-19. Further, in his zeal to combat American global dominance, he has adopted the “woke” narrative of the New York Times 1619 Project, and he tells us, it has much to teach us. Evidently, its well-documented distortions leave him unmoved, and the white race must repent in sackcloth and ashes for its sins. But enough of that: let us rather concentrate on Bacevich’s contributions to our understanding of American foreign policy.

David Gordon is Senior Fellow at the Mises Institute, and editor of the Mises Review.
Mises University 2021

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The faculty included senior scholars Dr. Joseph Salerno, Dr. Peter Klein, Dr. Jeffrey Herbener, Dr. David Gordon, and Dr. Patrick Newman. This year’s RGS cohort included scholars in a variety of disciplines: economics, history, political theory, and Native American studies, as well as current students in the Mises Institute’s Graduate Program.

On June 17, the Mises Institute held our first Medical Freedom Summit, featuring medical professionals, economists, and specialists who took a careful look at the way markets can improve the current state of American healthcare.

Lectures can be viewed at: mises.org/medical. This event was made possible thanks to Joe and Tracy Matarese.

**Speakers included:**

- Jeff Deist, “Can Economics Save Medicine?”
- Joe Matarese, “Medical Staffing and the Revolutionary Innovations We Need”
- Nick Vailas, “Bringing the Free Market to the Healthcare Bazar”
- Dr. Ben Powell, “Follow the (Economic) Science: Why Lockdowns Were Bad Pandemic Policy”
- Dr. Peter St. Onge, “What Canada Can Teach Us about Medical Freedom”
- Dr. Adam Wheeler, “Direct Primary Care: Aligning Incentives in Healthcare”
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