



**WOODS:** I've had a number of requests for a topic just like this, because I don't know that we've ever lived through anything like this. Certainly we haven't in our lifetimes lived through it. But as a country, I guess the only comparison would be wartime. And even there, you had some activities shut down to be diverted to war production, I suppose, so that may be some kind of parallel, but really, this seems like its own kind of thing. And so it seems like, as horrible and tragic as it is, it might be an interesting case study, because maybe by looking at the way the international division of labor is disrupted, it helps us to understand it better and how it is supposed to work in peacetime.

Now, let me start off with one thing that has been occurring to me, and that has to do with the distinction between essential and non-essential businesses. Now, I admit I haven't looked closely at the criteria they're using for determining what's essential and what's non-essential. But it seems to me that that very characterization carries with it a kind of central planning mentality, because it may seem to the naive central planner, this business is really not essential, but it turns out that given the interlocking nature of the different stages of production and how complex it all is, the absence of one of them could seriously disrupt other things. And maybe this particular thing this person is doing seems unnecessary, but it turns out that if my air conditioning goes out, I need that guy. I need that product. And without that, all the hospitals are going to be 110 degrees, that sort of thing. Am I off base on this? I'd like to know what each of you thinks about that.

**SALERNO:** Well, the structure of production, which is really just the latticework of interrelated firms throughout the economy, related in very different ways horizontally, vertically, as inputs and outputs, no one can really survey that mentally. No one can get a grasp on its complexity. So the problem is that, as you said, there will be gaps that will ramify throughout the structure of production, and that will shrink the economy. And that's what we have right now. We have a supply-side shock that is shrinking the economy, and the Fed, with all its different programs that do essentially the same thing, create money, cannot do anything to repair those gaps, some of which are caused by people being sick and staying home, but most of which are being caused by government mandates to shut down the businesses.

**WOODS:** Peter, what are your thoughts?

**KLEIN:** Yeah, I think you're exactly right, and the mere fact that the bureaucrats think they can make this sort of clean distinction between essential and non-essential illustrates that they don't understand the interconnectedness of all the different activities in the economy. I've pointed out to people that the current lockdowns and shelter-in-place requirements and so forth can have a lot of negative spillover effects on scientific research, including research needed to find new treatments, both preventative and therapeutic, for coronavirus.

And sometimes people tell me in response, *Oh no, no, that's not a problem at all, because these lockdown orders, they exempt healthcare workers and scientific personnel who are working on a cure.* But of course, that simply illustrates that these folks don't understand how all of these different things are connected. I mean, the scientist who needs to commute to work to be able to get to the lab to work on a coronavirus treatment obviously needs food, needs transportation. If that person's car has problems or has a flat tire, they need a

mechanic. Well, the mechanic needs tools and equipment and food and transportation and housing for himself and maybe schooling for his children and so forth. I mean, all of these things kind of fit together, such that there are tremendous spillovers, negative spillovers from shutting down one section of the economy on other sectors of the economy.

And I think also, maybe this is sort of implicit in your question as well, the mentality of central planning, this idea that, well, it's perfectly fine for the authorities to make these sort of distinctions between important and less important activities and to tell us which are which and to sort of direct people and to say which businesses can open and close. I mean, that mindset is something that I fear will stay with us much longer than the coronavirus health crisis.

**WOODS:** I want to know, given that so many people are just not working — some people are working from home, but there are only so many things you can do from home — how will this manifest itself over time? The fact that I guess it must be a huge array of things are just not getting done and things are not being produced. Right now, it doesn't seem that bad, because presumably we have inventories and backlogs of products, and I don't really notice a difference. But surely, at some point, this gets felt. How does it get felt?

**SALERNO:** Well, I think if you want to talk about statistics, in a shrinkage or reduction of GDP, there are estimates that in the second quarter, GDP will shrink by 20%. I've heard from the Bank of America, Goldman Sachs, they're all talking in these terms. Others are saying that this is going to take a year and that it could shrink by 10%, the GDP. So stuff is not going to be produced, because as Peter pointed out, there are ramifications from shutting down one industry. It's just not that industry itself whose output is lost, but many other industries that depend on that particular industry.

**KLEIN:** Yeah, and I think, Tom, there are also ramifications that will be harder to see right away in the aggregate data. There are changes in the composition of production and trade. For example, to make the obvious point, small business has been tremendously hurt by the lockdown orders, but Amazon, of course, is thriving and hiring more people. Some of the local retailers, grocery chains, Walmart and so forth, are expanding, as they need to, because these are businesses that are exempt from the lockdown orders.

Just yesterday, I was out and about in my town going to a couple of grocery stores. The big chain stores, of course, were open and thriving, but I went to one small kind of specialty food market. It's sort of like a restaurant. No one is allowed to go in, but they are allowed to operate a drive-thru lane. But of course, this is a small, local shop. I only go there occasionally. I really have no idea what to put on a shopping list unless I can go in and walk around. So the drive-thru was not useful to me, because I need to go in and see what's available that day to know what to buy. Whereas at the standard grocery store or at Walmart or Amazon where I get my staples, I can go to Walmart.com and place an order and then go pick it up without having to leave my car. I can't do that for the mom-and-pop. So clearly, one effect of the current policy response is that we're going to see some businesses helped and some businesses harmed, again, not in a way that's consistent with consumer preferences, but consistent with the policies enacted by bureaucrats.

**WOODS:** Let me ask you guys a question I have asked Bob Murphy and Peter Schiff. I just want to get your thoughts as well. Typically the rhetoric we tend to use when talking about bailouts and whether they are defensible run something like this: that we don't want to bail out firms or industries, because then that just rewards irresponsible management of those firms or industry. So instead, we prefer bankruptcy to proceed and ownership to pass into more capable hands. Now, there's nothing wrong with that. That makes perfect sense.

But what I was saying was, just rhetorically, does that not sound a little tone deaf right now, when, are we really saying, *Boy, these are terrible managers of these firms because they didn't anticipate a once-in-100-years pandemic that would lead to massive closures across the globe?* Are we really saying that makes them bad entrepreneurs who should be punished? And

the answer Peter Schiff gave was along the lines of, well, if like responsible people, they had prepared for a rainy day, they'd have a fund to see them through these difficult times. But they don't, partly because their business model expects just cheap credit to continue forever. Well, how do you guys respond to that?

**SALERNO:** I think that's correct. I think the economy, since the 1970s, has become awash in debt, and businesses have become more and more addicted to cheap credit as a backstop and have not built up surpluses. Especially since the financial crisis, this is a problem. Now, you can argue about whether or not it's the fault of the current management since this is the way things are done today, but what we need is something that purges people's mentality of this. We don't need it, but this is an opportunity to do that.

And also, I think relative prices have to adjust. Things will not be the same after this pandemic as they were before. And so some businesses will be permanently smaller or some businesses will close. Industries will be permanently smaller, and we don't know which ones are the ones that will be affected in that way, so we have to allow the market to play itself out.

**KLEIN:** Yeah, I think that's right. I'm sensitive to wanting to express the point in a way that doesn't sound tone deaf or that seems to apply moral judgment to those entrepreneurs whose businesses cannot make it just exactly right. It's more about kind of the environment in which we live, an environment that has been established by central banking and other forms of government policy.

At the same time, remember, as Murray Rothbard liked to emphasize, bankruptcy doesn't mean that the physical assets – and nowadays we might say the human capital or the knowledge assets of the skilled workers and so forth – all of a sudden vanishes. So if small businesses and medium-sized businesses, even large ones, have to shut down via the bankruptcy process, it may be that those assets are still useful and maybe managed in a slightly different way, or even managed in more or less the same way. It could be that once business kicks up again and new owners are found for those ventures – I mean, it might have been that the previous owners were just as good as or no worse than any other feasible owners on the scene.

So it isn't the case that all of that economic activity will go away and that all of those managers and entrepreneurs will necessarily be completely locked out of the division of labor. They'll find another place, maybe not doing exactly the same type of work, maybe not owning exactly the same assets as before. There's this constant sorting process within the competitive process of the market that operates during normal times, but it also operates during extraordinary times, as well.

And I think that's an important more general point that applies to competition, entrepreneurship, and the price mechanism. Those things can work and should continue to work and be allowed to work even during extraordinary times, even during a huge supply shock. Your listeners probably have heard this story many times about price gouging and the problem with price controls and laws against price gouging during a natural disaster or during something like an epidemic like we have now. I mean, the same applies to the bankruptcy code and competition among firms, competition among banks, and so forth. There's no reason why we have to suspend the normal working of the markets in the face of a huge supply shock. On the contrary, this is when we want to rely on markets rather than planning even more than ever.

**WOODS:** Before we get into what the Fed's response has been and what the federal government wants to do, let me ask you, for the sake of argument, let's say that since the crisis of 2008, the US government had endorsed a completely sound money policy. So let's take the Fed out of the equation of the past dozen years or so. I'd like you to contrast for us what an economy that has just spiraled into recession because of an Austrian business cycle, because you had an artificial increase in credit by generally a central bank, and then there

are problems related to that, and the recession follows — contrast what that looks like with the kind of recession everybody says we're going to have now that's just a supply shock that could just as easily have hit a gold standard economy. How do these two situations differ?

**SALERNO:** Tom, I think the difference — this is a very good question — is that in the current case, the supply shock will have ramifications because of the fractional reserve banking system and the very fragile financial system that we have. Again, since this '70s, we've had an over-financialization of the economy, where the real economy, the whole structure of production, the aggregates of capital that entrepreneurs have brought together in firms and the connections between those firms, that should be the dog that wags the tail.

That's where the interest rate is determined, actually. It's the rate of return throughout the economy to investment in these firms. And the interest rate that everyone talks about, the financial interest rate on loan contracts, is really just the tail. It reflects the rate of return structure of production. That has changed because of the Fed. So in bailing out and having a "too big to fail" policy, what has happened is that these financial firms have become enormous, and the cheap credit that they have injected throughout the structure of production has caused fragility among the even the firms.

So the bottom line I think is this: that there is much greater chance of collapse that wouldn't need to take place under a gold standard, that the supply shock under a gold standard would be just that, a supply shock. Some business would close down. People would be out of work for a while, and they would then come back and production would start again. But now we have the complications of collapses that are purely financial. And this I think is the main difference.

**WOODS:** Peter, do you want to elaborate?

**KLEIN:** Yeah, I think that's exactly right, and I would just add that the sort of modern Fed-engineered system that we have now, it's also very different from a free market under the gold standard in the recovery phase, in that the mistakes that are made during the boom never get a chance to be corrected or purged because of stimulus and because of bailouts of individual companies and so forth. So what you would find in a free market system, if you had some kind of horrible supply shock caused by pandemic or war or whatever, is these disruptions would be sort of unwound or could be recovered from much more quickly.

I mean, Tom, you've written about the early 1920s in the US, when you had a very sudden contraction, but a much more rapid recovery. I mean, even today in the US economy, we're still suffering from the malinvestments that were made during the boom leading up to the financial crisis, which were never purged, which were never corrected. So I think it's this sort of long-lasting, permanent misallocation of resources because you don't get the necessary correction from a recession that dogs the performance of the economy today.

**WOODS:** All right, in this portion, I want to ask about, first of all, the Fed, what the Fed's response has been. And first of all, explain to me what the Fed is doing, and how the Fed must perceive the problem as compared to the way you guys perceive the problem that it would think its approach is the correct solution.

**SALERNO:** I thin, taking off from what Peter said, that the Fed realizes that the fragility of the financial system. So what they want to do is, and they stress this, is to prevent the bankruptcies and collapses that will result from financial difficulties that firms are having. And thus, they're flooding the economy with money. I think they do understand it's mainly or at least its origin is on the supply side and that it's mainly a supply shock, but they're afraid that there's going to be repercussions on the demand side. And so that's why they have this whole range of different ways of injecting money into the economy.

I wanted to mention, though, that one of the things that they act as if is a demand shock is this whole idea that the demand for airline tickets and hotel reservations and restaurants, that that has gone down. But let's assume for a moment that people continued to work, but

were fearful of going into planes and hotels and restaurants and changed their demand. What's happening there is really a relative shift in demand. That's not really a demand shock, because people are now staying at home and spending money on — for example, Hasbro, the toy maker, is doing tremendously. Monopoly games are flying off the shelves. Life games are flying off the shelves. So this is a shift in demand that's been brought about by this pandemic.

**WOODS:** Peter?

**KLEIN:** Yeah, no, I agree with Joe completely, that the biggest challenge that we face, I think, is this notion that it's appropriate for the central bank to respond to a supply shock with a massive stimulus program to try to boost aggregate demand. But the connection between the supply side and the demand side I think, you know, there's a lot of hand waving in terms of how the spillovers in the former affect the latter within kind of the mainstream conventional view, as opposed to the Austrian view.

And it is remarkable, and I guess this is sort of old hat at this point, but how the whole world is Keynesian in a sense, in the sense that we all understand that famous Richard Nixon phrase that I haven't seen anything in the mainstream discussion, even the slightest question about whether a kind of stimulus program like the ones we're seeing is appropriate. It's Wednesday morning as we're recording this, and the last the Senate reached agreement with the White House on a \$3 trillion stimulus package. There's lots of discussion about it and people quibbling about particular elements of this package, but I don't see anyone outside of our own Austrian circles even daring to suggest that maybe massive monetary and fiscal stimulus is not the appropriate response to a real contraction in the real part of the economy. I mean, that's so far off of the, as Tom Woods would say, 3x5 card of allowable opinion, that doesn't even occur to anybody to raise this point.

**WOODS:** I want to turn to what the federal government is doing now with its bailouts of whoever and particularly the general public. I guess they're going to be sending people checks in the mail, and there's a huge price tag attached to all this. And I guess the thinking is: we're demanding that people go to their homes and stay there. They can't make their ordinary living. And yet, we don't want civil unrest, and we don't want people to starve, so we're going to have to send them some checks. That's the logic of it. How can we argue with that logic, he asks rhetorically. What do you guys say about this? I mean, how would you answer the man in the street to whom that logic seems appealing?

**KLEIN:** Yeah. Well, I mean, as Joe already pointed out, if the issue were simply people's unwillingness to patronize certain kinds of businesses, unwillingness to engage in economic activity, you'd think, *Oh, well, just give me a check. I can't work, so just write a check out of thin air. Give that to me as my salary. Give me a subsidy so that I can go out and buy things rather than working.* I mean, if it were that easy to create real wealth out of thin air, I mean, why would we ever not do it? Why would require people to work at all under any circumstances? Why not just create one of those economies like you see in a bad episode of *Star Trek*, some near-future society where we'll sit around and engage in philosophical dialogue, and no goods and services are ever produced, because we can just sort of magically wish them into existence. Times are tough now, but the fundamental laws of supply and demand, of production and exchange haven't changed, and you can't just print your way out of a crisis.

**SALERNO:** Yeah, I agree with what Peter's saying there, and that just the creation of money doesn't make up for the fact that less stuff is being produced. So if people really did rush out and spend this money — and that's not clear, since many of them are locked down in their homes — if they rushed out to spend this to spend this money, that's not going to replace the goods and services that are not being produced.

Now, there is another argument, and that is that they have to pay their debts, that there are debts that are coming due that were contracted in the past: mortgages, credit cards, and so

on. And that money is needed for that. But of course, I mean, in a situation like this, the banks, the mortgage companies, and so on, they all understand that that people are out of work. And banks don't want to foreclose on houses. If they realize that this is something that's out of the ordinary, it's an extraordinary event, they will work with those who have taken out the mortgages. They would rather have them earning an income and paying their debts. So they realize that there's been an interruption because of the pandemic.

**WOODS:** As we wrap up, what do you guys think the long-term consequences of the interventions will be, the Fed and the federal government?

**SALERNO:** I would say it's not so much the long-term consequences, which if they really do inject all this new money into the economy, it's going to be inflationary, particularly with small supply of goods available for a while. But I'm fearful of the mentality that it's instilled or is instilling into people. This whole idea that we can, as Peter was saying, sort of print our way into prosperity, and people getting direct checks from the government is a scary thought, because now that the barrier has been broken, it will be resorted to for smaller crises and other things that are going wrong in the economy. In fact, just yesterday, I saw an article by David Beckwith, who is someone who was in favor of the George Mason, I believe the Mercatus Center, and so he's in favor of stabilizing total spending in the economy. But beyond that, he thinks that in times of crisis, the Fed should have a rule that they send money directly to households, that helicopter money will now become an accepted tool for the Fed. So that's what I'm fearful of.

**KLEIN:** Yeah, I agree with all that. In the long run, I'm very worried about the ratchet effect, to use Bob Higgs' very useful metaphor. Actions by the Fed, by the Treasury, by Congress, by the president that are really striking and distressing to people in extraordinary times can quickly become the new normal. And I worry that in a future age which might be constituted by all kinds of crises, real or imagined, the notion that bold, decisive action by the state is necessary to protect us and keep us safe is just going to become more and more part of people's expectations.

We use the term "security theater" to describe all of these policies since 9/11. You know, no liquids more than three ounces and taking our shoes off and going through the porno scanners and so forth. Young people today have grown up in that environment and don't know what it was like to travel before 9/11. I wonder what kind of pandemic theater we'll have to live through after this is all over? I mean, will you have to have your temperature taken by some kind of TSA-equivalent worker every time you enter a public building. Will there be random health checks? I just worry that sort of socially, culturally, people are becoming more acclimated to a world in which the state controls the movements of persons and goods and the division of labor is retarded, and so forth, because it's just too dangerous to allow for a global division of labor. And maybe I'm overly pessimistic on that score, but I think we need to be especially vigilant, those of us who care about liberty, and try to push back against those things in the months and years to come.

**WOODS:** Well, I appreciate the insights of both you gentlemen and taking time like this at the last minute, but as I say, I've had a number of people wanting to know these things. And as you both have probably noticed, the commentary has not been very good. Everybody assumes that something like this needs to be done; it's just a question of the nuts and bolts of it. And I knew I could rely on our people to say, wait a minute. No, that is not it at all. The nuts and bolts are just rearranging deck chairs on the *Titanic*. So thanks to both of you very much.

**SALERNO:** You're welcome.

**KLEIN:** Yeah, thanks for inviting us, Tom. Back to Netflix now.