



Episode 1,737: Bob Murphy on How Money Works, and Against MMT

Guest: Bob Murphy

WOODS: It's been a long time, especially with no *Contra Krugman* anymore.

MURPHY: It has. I was going to say to you, I noticed in my life and I'm sure you have as well that I don't miss the fact that I don't read Krugman's column every week.

WOODS: I don't miss that, but I do miss our frantic efforts to throw something together at the last minute. That was always fun. Anyway, let's talk about your Understanding Money Mechanics series for the Mises Institute, where people are basically watching you write a book in real time. And wow, is it a necessary book, and maybe I'm going to steal your thunder here by kind of explaining to people why it matters.

But among other things, I would say this: when you look at the classic Austrian treatises – you look at *Human Action, Man, Economy, and State* – you get a very, very good understanding of money. But then if you look at a modern economics textbook and you look at the technical details of how the Fed works and stuff like that, it's not stuff that's covered at all in those texts. There's really nothing, very, very little about that in those texts. And there's a lot of terminology that you do not encounter in our foundational texts. And you're filling in those gaps so that we have an Austrian treatment that does include all this material and that does give our perspective on all of it. Am I getting the idea?

MURPHY: So thank you, and I think you're right, that's one idea. And I should mention that Jeff Deist was the one who pitched this idea to me, and so, oh, yeah, this sounds like a great idea. So it was his idea that I should work on this. And I think, though, partly, Tom, where he was coming from is a lot of people are not going to read *Man, Economy, and State* –

WOODS: That's another thing, yeah.

MURPHY: Especially, if they're not already Rothbardians. And so if we need the Austrian perspective to go toe-to-toe with MMT or whatever, we have to have something that's easier for people to get the essentials down.

WOODS: But also, something that expressly addresses MMT. Like in other words, if you have a really good Misesian-Rothbardian background, you can probably tease out what the argument against MMT has to be. But if I'm in a hurry, I'd rather just read what is the argument MMT? I'd rather have it less roundabout.

MURPHY: Right, right, that as well. So yes, you're right, that I guess what's different from this – like, oh, gee, I already read *Man, Economy, and State*. What's new in here? – There's nothing that contradicts it, obviously, but yeah, a lot of the stuff, I'll take particular arguments. And I have a whole section where I'm dealing with objections, for example, so that's certainly something that you wouldn't see in *Man, Economy, and State* because it's responding to people who don't like *Man, Economy, and State*.

WOODS: Yeah, and some of these are objections that are of quite recent origin. So by the way, whatever project you're working on, if you want me to come and explain to you what the ultimate significance of it is, you feel free anytime. You stop right on by.

MURPHY: [laughing] Well, that's great, because that way too, if you happen to like it, then I don't sound like a jerk.

WOODS: Yeah, yeah. Yeah, it works out perfectly. All right, let's start with one thing that I actually saw you say somewhere online, that when you were working on stuff relating to the history of the gold standard in the US, you were actually learning stuff you didn't know before. And that intrigued me. What did Bob Murphy not know that's a value to us?

MURPHY: Okay, so in here, what the chapter title is, "A Brief History of the Gold Standard With a Focus on the US," and so when I was brainstorming, okay, what kind of things do we need to cover, so clearly we had to have that in there. I think that's partly why modern Americans and people around the world don't have any idea what sound money is, because they grew up in a world based on government-issued fiat currency and they don't have that history. And so I think what happens, Tom, what I meant by saying that is I always heard people referring to, oh, William Jennings Bryan wanted the free coinage of silver and there was bimetallism, and I never had the time to read enough to know exactly what they were talking about. And so I didn't fully understand that stuff.

WOODS: And by the way, let me add, I think most historians writing about it like in textbooks, they don't really get it either, because they haven't delved into any of the real sources. They don't really understand what it's about, other than they think the silver people must have been the good guys and the gold standard people were the evil rich people. That's as far – I mean, I'm not kidding you, that is far as they know.

MURPHY: Well, and what's funny too, though, Tom, is because when you read Rothbard, his history, there is a sense in which the people pushing for the gold standard were the sinister ones, not that Rothbard was for, oh, let's go ahead and just keep creating silver to ease the farmers' debts. But it's funny, when I went to read Rothbard's background on what was happening, I was assuming all the gold people were going to be the good guys, and it didn't line up that way, either. Anyway, it was very interesting. It wasn't what I expected.

But specifically on this – and I guess I should say, Tom, part of the problem is, if historians don't know monetary theory, how could they possibly adequately describe what's going on during the Jennings Bryan-McKinley campaign, things like that, because they just don't know. So partly what I meant was that up till I did the research for this chapter, if you would have asked me, *Well, what's going on with the gold standard?* I think I probably would have said the two big events, the things I focused on were how Roosevelt first took the US off and then what Nixon finally came in and did.

And with this chapter that I did here for the Mises Institute book, I had to include them, obviously, but that was just things right at the end of the chapter. I spent the bulk of the time explaining what was going on before the Civil War, the bimetalism period and how all that worked. Because to me, that was the interesting thing, that for example, I think – and I used to think this – that a lot of people nowadays, even fans of the gold standard have this idea that, oh, yeah, the US government from the moment the Constitution was ratified was issuing green pieces of paper with presidents on them – which would be difficult because they wouldn't know whose face do we put on these things yet. But that there was a pledge that, oh, you turn in these green pieces of paper, and then you get a certain amount of gold or silver. And that's not what it was. Originally, no, US dollars were in gold and silver coins, so \$10 gold coin, for example, or a \$1 or a 50-cent piece in silver. And that's what the money was.

It wasn't until the Civil War when the US federal government actually started printing, they called them greenbacks, things that nowadays we would think of as US currency. And that wasn't just an accident. The founders had seen with their own eyes the inflation during the Revolutionary War, the phrase "not worth a continental," referring to the continental currency. And so the idea was they wanted gold and silver coins out there so that any transaction could be conducted literally just with coins, that for more expensive things you'd use gold and then for smaller stuff or change, you'd have the silver pieces.

And so that was something that I didn't fully appreciate until doing this, that our notion of what does it mean to have a gold-backed currency, back then people literally had gold and silver coins in their pockets walking around going to the store. It wasn't just that, oh, yeah, the paper the government prints, they promised to back it up if you turn it in. That was something that came later in the process of weaning people off of hard money.

WOODS: Well, let me ask you the key thing about gold and silver. We have no particular opposition – if the issue simply is allow gold and silver to circulate as money, well, stated that way, we have no problem. But there's no way that that could be the whole issue, because then why would it be portrayed as a way of easing the burden on the poor and downtrodden? Was it that they wanted to fix the two coins at an unreasonable ratio so that people could pay off debts in basically not enough money, in effect? I mean, what was the real issue there?

MURPHY: Okay, great question. And so, yeah, what happened was originally the dollar was defined as a certain weight of gold or silver in terms of grains of the pure quantity of each one. And it worked out that it was, depending on the type, you're like 15.5 or 16 or 15 to 1 in terms of the weight of silver you would need to equal \$1 versus the physical weight of gold. Okay, so like I said, that's what I'm trying to get people to realize too, is it wasn't like nowadays, if the Fed promises – or pledges, I should say, is a better term – that oh, we're going to try to keep price inflation between 1 and 2%, it wasn't that back then they were saying we're going to try to issue US dollars such that the gold price falls in this range. No, the dollar was defined as that, so if you went in with a certain amount of raw gold or silver, they would physically stamp them into coins for you. And so the quantity of dollars was not set by the authorities. Instead, the authorities were basically setting what the price of a dollar was in terms of gold or silver, and then people themselves determined the quantity.

So they had at some point suspended what was called the free coinage of silver, meaning they announced from now on, if you bring us raw silver, we're not going to turn it into US dollars,

coins stamped with the appropriate denomination on them. We're going to discontinue doing that. And so as more and more countries did that – and this would be like after 1879 and onward – the world price of silver fell relative to gold and other commodities because fewer and fewer governments were using silver as the money.

And so if you just think about it, Tom, so what would happen then if all of a sudden William Jennings Bryan has campaign to reintroduce the free coinage of silver, what that meant was they were going to resume the policy, if he got his way, where people would go to the US authorities, give them raw silver, and they would take it and stamp it into more US dollars, for example, like a \$1 piece made out of silver. So that would be increasing the number of dollars, so that would cause price inflation measured in dollars. So if you were a farmer and you had a mortgage on your farm denominated in dollars, by reintroducing the free coinage of silver, that would effectively be allowing for the creation of a lot more dollars. Because what's going on is the price that they had had on the books originally, silver was no longer worth that much in the world market.

So in other words, the amount of silver you would need to be stamped into a US dollar was not worth \$1 if you just sold it raw on the open commodity markets. So there would be a lot of silver that would flow into that outlet if Bryan's policy had been reintroduced, until they had created enough new dollars consisting of silver coins that the purchasing power of the dollar had weakened enough so that now, it fell to what the world price of silver was, if that makes sense. So it was just a way of allowing citizens to create more dollars.

WOODS: Okay, so is it obvious then that the average person benefited in some way? And if the average person benefited, was he benefiting at the expense of the rich or his employer or something?

MURPHY: You're saying if they had allowed that policy to go through?

WOODS: Yeah, yeah, exactly. If William Jennings Bryan had gotten his way, let's say.

MURPHY: By the way, I know you know this, Tom, but for the benefit of the listeners, don't be confused. So he lost, folks. This was the – what was it, Tom, was it the 1896 election?

WOODS: Yeah, there was never a President Bryan. And he tried several times, even from prison.

MURPHY: [laughing] Yes. And so it was that campaign that he had his famous Cross of Gold speech at the Democratic convention when they nominated him, so that that's the period that we're talking about.

WOODS: By the way, I don't know why I was thinking of Eugene Debs [laughing]. Obviously Bryan was never in prison. So there was no part of American history that you missed; it's just I wake up at 6:30 now to take my kids to school and it's pretty brutal. [laughing] So I'm sorry I made that mistake.

MURPHY: Well, no, I was thinking like I know he resigned, but I don't remember –

WOODS: [laughing] Yeah, he resigned over the aggression –

MURPHY: [laughing] Did that SOB Wilson throw him in jail?

WOODS: [laughing] Yeah, right. He thought Wilson was hit was heading toward war, and so he resigned. But you don't actually get imprisoned for resigning. All right, let's go on.

MURPHY: So, yeah, if you're asking, Tom, what would have been the effects if he had gotten that through? So certainly, there would have been an immediate redistribution from creditors to debtors, because anybody with an unexpected price inflation, that people who owe debts denominated in the currency, they experience a relative easing and the creditors get hurt. But as with any kind of inflation, I think there's more sinister consequences it would set in motion depending on the specifics, the Austrian boom-bust cycle, for example. And so just in general, just to say what if we just allowed the debasement of the currency every five years, would that help poor people? I would say no, that there might be some effects that directly help them in terms of easing their debt, but on the other hand – and of course, there are plenty of lower income people who are frugal and who would have had savings, and they would have been the creditors that would have been hurt too. So I don't think we should buy into this notion that all the people who have savings are rich people and all the debtors are poor people. There's plenty of spendthrift upper income people too who are carrying a lot of debt, for example.

WOODS: Let's go on. I've got a couple more topics I want to hit that are covered in this extremely expansive, would-be and eventually will-be book. Because this is one that I've encountered myself. I get people saying, *Oh gosh, you Austrians are so living in the past with your analysis of how banking works. It doesn't work like that. If it ever did, it doesn't work like that anymore.* So for example, they'll say banks are not actually constrained by reserves, like we've got this formula where banks have to keep such-and-such reserve, and then they create credit on top of the reserves and all that. And I've gotten this on my blog, and repeatedly, *Oh, you stupid fools. That's not how it works anymore.* So is that the kind of thing you're addressing in that section?

MURPHY: Precisely, right. So yeah, there's a chapter, folks, that said: do the textbooks get money and banking backwards? And you're exactly right, Tom. And this was something over the years, I had noticed. Like I would get just at the beginning seeming cranks emailing – and by the way, not that there's anything wrong with that, folks. Some of my best friends are cranks.

WOODS: Yeah, he's talking to one of them right now.

MURPHY: But yeah, saying, hey, this conventional – So the conventional story, very quickly, is to say, oh – and this isn't just an Austrian thing. This is how any money and banking textbook would have explained this stuff from a few decades ago – is to say, oh, the way that the central bank eases – like talking about the US – the Federal Reserve goes and they buy assets in the open market, and then that adds reserves to the banking system, and then because there's a reserve requirement, that allows banks who had originally been fully "loaned up," now that they have more reserves, those are now excess reserves, and they can go and lend out, let's say, 10 times when the system settles down of the new reserves that were injected because of the fractional reserve nature. You know, you get an extra \$1,000 deposit, the bank can lend out 900 of it, and then someone else in the community deposits the 900 in his bank, and so then their bank can lend out 90%, and it just keeps going on.

So that's the conventional story. And so the idea there, the spirit of it is the banks are sitting around waiting for the Federal Reserve to come along and inject new reserves before the banks can then make more loans. And so the critics say that is, if anything, backwards. Regular commercial banks, they will argue, they don't even care what their reserves are, because they'll go — you know, somebody applies for a loan, the loan officer doesn't call the home office and say, "Hey, do we have any excess reserves? Or do we have to wait for the Fed to do an open" — No, they'll just say, is this a good loan or not? And then they'll go ahead and make it. And if the bank then realizes, uh oh, we don't have enough reserves to meet our reserve requirements, they'll go out into the federal funds market and borrow the reserves they need.

And then you say, well, okay, but what if there's not enough for the system as a whole? And they'll say, oh, well, then the Fed will provide more reserves. So the Fed sort of passively reacts. And it's like business decisions that push the Fed's hand or forces the Fed's hand. It's not the Fed running the show. So that's the kind of thing they'll get. And so you can see how, geez, yeah, if anything that seems like it's the exact opposite or backwards from what you would read in a standard money and banking textbook.

So what I do in the chapter, Tom, is try to say they're actually both correct ways of describing what would happen based on your assumptions about what's fixed or not. So if what's fixed is the quantity of reserves in the system — like the Fed is going to stay still and they're not going to buy any more assets — then things proceed exactly the way the orthodox textbooks describe: the banks can only lend up to a certain amount. There's reserve requirements. Commercial banks don't have the legal ability to create reserves. Only the central bank can. And so if there's not enough reserves to go around, then they can't make more new loans, that you could say, oh, you can go borrow it from somebody else, but then that means that bank that lent it doesn't have those reserves, right? So that's correct.

However, if what instead you're going to say is, suppose what the Fed is doing is just setting like a target for the federal funds rate — like maybe the Fed's going to say we want the federal funds rate to be like 3% — what that actually is, that interest rate is saying that's the interest rate the commercial banks pay on overnight loans of reserves. And so if you think that through, what would happen then is, let's say all of a sudden the commercial banks see a bunch of good lending opportunities and so they want to make more loans, and then they are scrambling now to get those scarce reserves to be able to satisfy their legal reserve requirements. That's going to push up the federal funds rate as more of them are scrambling to borrow those limited quantity of reserves. So then the Fed's saying, oh, gee, we had a target of whatever I said, 3%, and now the federal funds rate is 3.5%. We've got to go in and push that back down to our target. And so how do they push it down? They buy more assets, they inject more reserves into the system.

Okay, so what I'm saying, Tom, is it is true that you can imagine if the Fed's behaving in a way, if they're targeting this particular interest rate — which in practice in normal times, at least before all this QE stuff, is how they operated at least on a day-to-day basis in terms of how they couch their policy — then there is validity to the way that these critics explain the process. But on the other hand, there's nothing wrong with what the orthodox textbooks say. Again, it just matters as to what do you think drives the Fed's behavior? And that, yes, if they don't want that federal funds rate to go above a certain level, then they are going to push it down. But the way they push it down is by doing exactly what the orthodox textbooks said they did.

WOODS: Okay, now let's turn to the final thing. And I know you don't want to talk about this. I totally understand you're sick and tired. Nobody at this point wants to talk about it anymore. But unfortunately, we are living at a time when not only is modern monetary theory gaining adherence and attention just for whatever reason of its own accord, but the particular circumstances in which we're living seem to be exactly ones in which they would be able to hawk their wares effectively, because they would say:

Well, obviously we're living through an emergency, and obviously if we're going to sit around and pretend that the government is constrained in its spending, we're going to cause all kinds of major social problems. So it's a good thing we have modern monetary theory in order to undo some of the superstitions that supporters of austerity have put in your heads, that namely the government does operate under certain financial and resource constraints and blah, blah, blah. Well, we're here to tell you that that's not the case, and so on and on.

Now, I know I'm not actually even trying to state what modern monetary theory is, but that's the popular-level version that is without a doubt being communicated to people, that really, all that is holding us back from accomplishing what we need is just will, is political will. There are no other constraints other than political will. Now, that may be a controversial statement. Would you say that that's what an MMTer would say in this situation?

MURPHY: I think so. Yes, so they certainly wouldn't be afraid to say any of the things you just said there. I think their distinctive trademark is certainly what Stephanie Kelton does, is they want to say: oh, the modern political discourse is so sophomoric and just misguided, everyone keeps talking about how are we going to afford the Green New Deal or health care for everybody or whatever? And that's just totally the wrong way to look at it. The US government has a printing press, and moreover, most of the debts that it owes are denominated in dollars. So there's no question that they can "afford" anything they want in the sense of, are we going to be able to come up with enough dollar bills to satisfy our creditors? The only constraint they'll say is, yeah, if you print too many of those things, then prices are going to rise too much. Don't get us wrong. It's not like it's we can have anything we want. But let's stop using the wrong terminology. The issue is not: *can we afford this?* The issue is: if we did have the government purchase this or finance it, would that cause unacceptable resource constraints or log jams elsewhere that would cause prices to shoot up too much?

So that's true insofar as it goes, but it's sort of like normal orthodox economists, I think our reaction to that is, well, right, we never denied that you had a printing press. In fact, we spend a lot of time denouncing that. and I'm sure you remember this too, Tom. I mean, growing up in the sort of free market tradition, it was standard where economists would say things like, hey, there's only three ways the government can pay for something. Don't think you get something for nothing. The government either taxes you, borrows, which is kind of like future taxation, or they print money, which is sort of like hidden taxation. Those are the only three ways government can finance anything, so when you ask for the government to give you something, just keep in mind it's basically taking it from you in the first place. So that was standard stuff.

So this idea that the MMTers are going to come along and let us know: hey, instead of taxing and borrowing, don't you realize there's a printing press sitting over here? Why don't we use that? Like, yeah, we know that. And we know what the downfall is, that it causes prices to

rise. And this is why MMT, I understand its fans, they'll always say, *See? Everybody agrees that what we're saying is correct. They just don't like it.* And you know what I mean? Like I get why they're saying that. It's very rhetorically effective. But what we're saying is yes, what you're saying is something that we knew all along, and it's not a solution.

WOODS: Yeah, now, that's exactly what people need, by the way, what you just said, because you could argue all day long with an MMT person. You could be arguing technical details all day long. It's the bird's-eye overview of what the problem with it is that people generally need. The average person who's not going to study economics in any detail just wants to know, what's the bird's-eye view? What is it that they're missing? How are they looking at the world that's causing them not to see what I see? Right, so what's the pithiest answer to: these people are claiming that my concerns are absolutely unfounded and amount to a complete misconception of the whole nature of the world. How could I be so wrong? I mean, it doesn't feel like I'm saying anything unreasonable. So I mean, let's even nail it down even further. What's the pithiest kind of response that can buck up the courage of that guy and say, *Oh, you know what? I was right the first time?*

MURPHY: Okay, so I think that besides just them sort of coming at it from a different angle and saying things that, yes, technically, it's true from an accounting sense and we just disagree about the implications – I think what's really driving the difference in why they think pointing out these truisms about, *Hey, don't the US government never needs to default? They can always just print more hundred dollar bills* – why they think that's such an important insight to the budget debates is they think there's a lot of slack capacity, especially in recent times, where they're like:

Look at all the QE the Fed's done, and gasoline is not \$10 a gallon, so what are you guys talking about? Clearly, we have a huge margin where the authorities could create trillions more dollars without causing any noticeable price inflation at the store. And then you could get trillions of dollars of more stuff.

So that's what they think, whereas typical Austrians don't think anything like that. They think you're printing that money, no matter what CPI is doing, you're clearly redistributing away from the private sector to the people who are the recipients of that new money, number one. And so you think ethically, that's indefensible redistribution of wealth or property titles. But beyond that, depending on how the new money enters the system, it might set in motion the standard Austrian boom-bust cycle. So they're not seeing that.

And then you might remember, Tom, I had Warren Mosler, who's like one of the modern founders of MMT on my show, and I tried to get him to – I wasn't debating him; I just wanted to understand. And I was saying, like, so if we were going to finance colonizing Mars or something, like do you think there's all these free resources just sitting around as slack and that we could just go ahead and do that, or would that cause – And he didn't necessarily say whether you could go to Mars or not without causing the prices to rise, but he definitely had this idea that there's a lot of unused capacity in the system right now and the MMT approach would unleash the policymakers and would give them the freedom to spend the money that would not cause any unintended consequences elsewhere in the system. So I think that's part of it.

So besides the thing we agree with them on, that yes, the government can just print money if it wants to finance things that way and then you don't need to worry about "paying for

something," they think that there's this huge slack physically in the system where a lot of people could go back to work and a lot of resources could get deployed to create things that society wants without having to reduce other things that society is currently getting out of the economic system. So to them, it's like a win-win or a free lunch.

WOODS: Does that mean that MMT applies only under particular conditions?

MURPHY: Okay, so great question. So, I mean, formally, no. Like in other words, just like a theorem is true whether or not the initial conditions are satisfied. So it's not that MMT would be wrong. They would say, if you didn't have this – but they would say, oh, if you're at a resource constraint, if you already have price inflation starting to rise like in Zimbabwe or something, it's not that MMT is wrong in Zimbabwe; they would just say no, what MMT teaches is you've got to ease up on the printing press once you see prices go through the roof. So they would still say MMT is correct. The Zimbabwean authorities can go ahead and pay defense contractors or whoever, people who run soup kitchens with Zimbabwe notes because they can just print more. But once that hyperinflation gets underway, then yep, clearly, you guys now have a real resource problem and you've got to ease up on that.

So I think maybe what you're trying to relate it, Tom, that somebody like Krugman, the way he distinguishes himself from MMT is he'll say, *Oh, we Keynesians know that when you're in a liquidity trap, all the rules go out the window and that budget deficits are expansionary and that there's no crowding out*, and blah, blah, blah. But once we're out of the liquidity trap, then the Keynesians, Krugman says, sound more like orthodox – it's not a Casey Mulligan or somebody, Newt Gingrich. Whereas the MMT people, Krugman things, they think it's always like this. And so that's, that's yes and no, and I asked Warren Mosler about that. And I think Krugman's largely correct, that the MMT people, even though they do acknowledge that yes, formally there could be a scenario where we would say let's stop printing money because now we've hit the resource constraint, in practice, they don't view it as something that just happens every once in a while during a bad business cycle the way that the Keynesians do, that it is this recurring feature, that the system carries a lot of slack with it based on the silly institutions we have in place.

WOODS: Well, I'm going to stop there, even though obviously, we could go on and on and on, but I don't want to do that to you. It's not fair. You've already written all this stuff out. So I'm going to direct people to the *Understanding Money Mechanics* series. It's so good, and the chapters yet to come look absolutely great. I don't really want to read any more books these days. I read enough books for the doggone podcast as it is, but I am definitely going to be reading this one very carefully. I'm very eagerly awaiting its release. So I'll link to the whole thing at TomWoods.com/1737. And I know you are an even busier guy than I am, Bob, so thanks for being with me today.

MURPHY: Thanks for having me, Tom.