



## Episode 721: The Moral and Material Disasters of Fiat Money

Guest: Philipp Bagus

**WOODS:** All right, let's talk about *Blind Robbery*. Nothing subtle about the title of this book. I want to talk about the ideas in the book, but then toward the end, just because I enjoy having a chance to pick your brain, I do want to ask you a few more advanced questions that aren't covered in the book, just because I want to know the answer and hear you are. But what this is, as I was telling people in the introduction, is a very useful book for people, first of all, who are new to some of these ideas, but even people who have been around a while I think will benefit from this, because you present the ideas in ways I haven't necessarily heard presented before and in ways that are very persuasive and that are step-by-step. Each point builds upon the previous one. So I think it's very, very well done. And it's not a long book, and it doesn't take very long to read. What are you hoping to accomplish? Somebody reads this book; how do you want his thinking changed by the end?

**BAGUS:** Yeah, the motivation for the book was that Andreas Marquart and I thought that probably the most important problem of our times is actually the monetary system. The monetary system in our view is the most urgent problem that we have in our society, in Western societies. Of course if you ask average people on the street, if you asked them what is the most urgent problem, most of them won't say the monetary system, and we wanted to change that.

The problem here is of course that the monetary system is very complex and very hard to understand, and most people won't go through Mises' *The Theory of Money and Credit* or through De Soto's *Money, Bank Credit, and Economic Cycles*. Very complex and large books. So we thought if this is a problem, if this is really the most urgent problem, what we have to do is convince people that something has to be changed in the monetary system, that it's fundamentally flawed. And in order to do this, we must reach many people. We must reach people we haven't reached before. Therefore, we wrote the book, and as you said, we tried to write it in a way that basically anyone can understand it, but also in a provocative way and in a funny way, so people like reading it. It's not a burden or something, but it's actually fun reading it.

**WOODS:** I'm going to — I'm going to skip ahead in a — I think, I don't know, a decent number of people listening know the basic argument about where money comes from and what problems it solves and what form it traditionally takes, things like that. Let's go ahead into something a little bit more advanced. You have a chapter on who is

allowed to create money and who is not. I think people just assume, even a lot of libertarians who haven't given the question much thought, would assume that money is unlike other commodities. They can see how fish could be sold on the free market or sneakers or steak dinners or whatever. They could see all that, but money doesn't seem obvious how you could sell money, how you could buy money. I buy and sell all these other things. So it is easier for them to be persuaded that some special agency has to supply the money. How are you able to explain in a way that's simple and yet compelling that actually money is not so different as compared to other goods in this regard?

**BAGUS:** Yeah, one thing that we use in the book again and again is that we go to a town or a city in the past and explain how money arrives through individual action, and then how the state comes in, and it's a king, and sees there his opportunity to get hands on the monetary system, on the money, to have more income. And money plays the system in his favor. And then he finds also, in another sequence of the story, he finds the banking system as a possible ally and gives the banking system the privilege of producing money in exchange for the banking system financing him, buying his bonds. And this comes very naturally, because before we explain how gold is mined by private miners, how it works very well, how the society's built. And then the state comes in and appropriates it, and everything gets messed up.

**WOODS:** All right, so I think that's one of the big problems people have with understanding our position in all this. It's hard for them to visualize it, hard for them to understand how it could be that we could survive without a monopoly on the issuance of money. But then there will be others who say, you know, at least the government or its central bank can carry out monetary policy. It can use money to guide the economy in certain ways. It can help, let's say, bring the economy back from a depression; it can help stimulate the economy by its use of its money monopoly. And this is a good thing, whereas if it were in private hands, heaven knows what would happen. What's wrong with that kind of objection?

**BAGUS:** Well, this is the fundamental error, to think that producing more money would make society richer. But producing more money does not produce more cars or more food or more services. It does not produce any real goods, so society does not get richer, and so society does not get out of recession because we produce more money. I mean, we could add a zero to all banknotes and to all bank accounts, and society would not be richer. So people who think that by producing money, or the money monopolists by producing money could make society richer, get society out of recession actually don't get these basics or just want to use the monetary system for some redistribution, because money production normally also leads to redistribution in favor of those who receive the new money first. So this seems to me more like an excuse for some redistribution in favor of the government, the banking system, and their friends.

**WOODS:** Let's talk about that, because you do make the argument in the book that people are concerned about inequality, but they don't make note of the role of the monetary system in exacerbating inequality. And you point out, for example — this

is not the only way that inequality is fostered by the monetary system, but for instance, there are distribution or Cantillon effects of the — when new money is created, it's not distributed evenly across the population. It enters the economy at discrete points, and if you happen to be at one of those discrete points, you get to enjoy the money before prices have risen commensurately, and this gives you a windfall, whereas everyone else is suffering a loss. But on the other hand — and it's true that people who have government contracts or are well connected to the government tend to be the ones getting the new money first.

But on the other hand, wouldn't people receiving transfer payments, like social security and welfare and food stamps, wouldn't they also be getting the new money first? So wouldn't it just be a wash, that the poor would also get some new money, so it's about even?

**BAGUS:** It's of course true that the non-producers that get the transfer payments are also one of the first receivers, tend to be one of the first receivers, because they get it directly from the government. So it's totally correct what you say, but I don't think it's totally even, because when the banking system produces new money, a big part goes to the government, but then we have to think who gets the money from the banks in form of new credits. And there we have to say that someone who owns assets that he can pledge as collateral in order to get a new loan, in order to get the new money, has an advantage over the person who does not own any assets. So if you own real estate or stocks, you can pledge them as a collateral to get a new loan. But if you are poor, really poor, you don't own real estate, you're just renting it, and you don't own any stocks, then it's very difficult for you to get a loan in normal times. In boom times, in bubble times, then you will also get the loan to buy a house [inaudible] later.

But here the main argument is that if you are rich, the chances are that you will get a higher proportion of the new loans created, the new money created. If you are George Soros, for example, you just call the bank, have a good connection to your bank, you just call it and say you want a 1 billion euro loan to speculate against a currency, for example, and you will get it. But if you are poor, you won't get so much money so easily. Rather, you will see that always new money is created and that prices go up and your bills, your gas bill will get ever higher, and you will probably not understand why. And it's because George Soros gets all the new money.

**WOODS:** All right, let's shift gears away from George Soros for a minute. I want to ask you about a complaint that we hear from people like Paul Krugman about the sorts of things you're saying. He would say, of all things in the world to be concerned about right now, price inflation has got to be the absolute lowest. We have a lot of things wrong with the economies in the Western world, but surely price inflation is not one of them, and people who have been concerned about it now look vaguely ridiculous. And yet in your book, you have all kinds of warnings about price inflation, and yet price inflation, even if we acknowledge that maybe the government understates it — and even that I think is overdone a bit — it's still been quite mild, at least by 20th century standards. So why worry about it?

**BAGUS:** (laughing) Because it could be around the corner. But beside that — I mean, if in the past few years there hasn't been price inflation, that doesn't mean that in the next five years there won't be. And of course there has been price inflation, mostly in asset price markets, in the stock market, for example, but also in some countries in the real estate markets. So prices have risen very fast. For example, in Germany the real estate market has risen very much.

But here the point is actually now how the price level changes in relation to the arguments that we do. The redistribution that is occurring due to the production of the new money occurs independent from the change of the price level. Or to put it in other words, what is important is the change in the money supply. If there's a huge change in the money supply, there's much new money produced, then there's a huge redistribution. Even if prices are constant, it could be that there are other factors that compensate for the increase in the money supply, and there have been these factors in the past 30, 40 years, because there has been globalization.

It's basically 1 or 2 billion people have been incorporated into the international division of labor. I mean, China and India basically did not exist 30 or 40 years ago from the point of view of human action for a European or American, because there was no exchange with them. Now suddenly we get 2 billion people more producing goods and services and exchanging with us. The iPhone, the computer you're using are probably made in China. 40 years ago that was not the case.

So this of course led to a tremendous growth. And also, huge revolution in technology: the Internet, information technology, a huge revolution, huge productivity increases. If the money supply would have been constant, probably prices would have fallen 30 or 40% or, I don't know, even more. But prices did not fall but kept rising. So this tells us that there has been a huge increase in the money supply and also a huge redistribution. So the poor maybe did not see prices rise so fast, but they could not enjoy the price fall that would have occurred in the money supply would not have increased and the new money would have been given to the government, to the banks, and to the rich.

**WOODS:** Let me ask you something that I hear a lot of confusion about. Suppose we had a gold standard — or yeah, even just a classical gold standard enforced by the government — and the money supply is then increased by means of gold mining. So there's now more money than there was before, and the introduction of the gold into the economy also occurs at discrete points. So why would that be considered legitimate, let's say from a moral standpoint, but the introduction of fiat money by the government into the economy would be morally suspect? What's the difference?

**BAGUS:** Well, the difference is that anyone can mine gold, but only the Fed can print dollars. I cannot print dollars; I cannot print euros, but I can go in my garden and mine for gold, or buy some land in Africa to mine for gold. So from a moral point of view, it's the monopoly of the money production that is the problem in fiat money. The monopoly for base money production is at the Fed or the ECB, and they have this kind of franchise where they give also the banking system to produce money substitutes,

while within a gold standard everyone can try to find and mine gold. And this normally has also very high cost, while of course the production of fiat money is virtually nil in the case of electronic money, and in the case of paper money also very low. So these are the differences.

**WOODS:** And of course the production of gold in that place would be taking place within the realm of economic calculation and profit and loss, and so you would know – there would be a natural point where the most profitable thing to do in the world would not be to mine additional gold, whereas with fiat money produced by the government, not only is there no profit and loss feedback, but of course it's pretty much costless to create the money. So there are no constraints on money creation, whereas the constraints under a gold standard would be the constraints of the marketplace, the constraints of scarcity and competition for resources, and it doesn't make sense to pour all resources into the production of gold.

Now, what about the effects on the overall economy? Of an injection of fiat money into the system and, let's say, an increase in gold mining? How is it different? Like for instance, is the business cycle created – I get this a lot. Is there a business cycle simply because there's more gold in the economy now?

**BAGUS:** Yeah, that is a good question also. In the case of fiat money, the new money is normally introduced through the credit market, the loan market. So the new money is produced by the banking system, introduced into the loan market, and this lowers the interest rate artificially below the rate it would otherwise have, while in the case of a gold standard, gold production, the new money goes first to, well, the miners, and then whatever they buy with the gold. But we cannot suppose that it changes actually the interest rate, that it manipulates, that it changes the interest rate, because the new money, the new gold does not go into the loan market, but it just goes to the owner of the gold mine. And then he buys, I don't know, a car or a house, so the price of the car goes up or the price of the house goes up, while in the case of fiat money, the new money goes through the loan market, and there manipulates the most important price in the economy; that is, the interest rate. That is very important for the coordination between saving and consumption.

**WOODS:** All right, now let me ask you something a little bit more technical, if I may. I want to talk about – I don't expect you to be an economic historian of the US, but I know you know about the debate between – or the way Rothbard looked at the Great Depression and the way somebody like Milton Friedman looked at it. But sometimes they'll throw Hayek in your face, and they'll say even Hayek would say – and by the way, I'm thinking of that great article that you wrote years ago – gosh, I hope that was you. I'm going to be embarrassed if it was somebody else – where you critiqued all the Austrian economists for their deviationist views on deflation. Was that your article?

**BAGUS:** (laughing) Yes, yes.

**WOODS:** Oh, thank goodness (laughing). I feel better. And I'm sure — I don't remember it well enough. I'm sure you had plenty to say about Hayek. But he said, look, I am not in favor of inflation, but I'm not in favor of deflation either, and at some point — he seemed to leave open room for the monetary authority to intervene in certain cases. Can you elaborate on that and explain what would be wrong with that?

**BAGUS:** Yes, I mean, this — not only Hayek, but many free market economists think that after an artificial boom, when then the bust comes and the credit contraction, there's some place for the government or the central bank to be in order to prevent a credit contraction to run its full course, because it could — well, it could bring down the whole banking system, and through severe price deflation it could cause many, many bankruptcies in the economy, because when prices fall it gets ever more difficult to service your debt that is normally fixed. So when there has been a long boom and prices have risen many, many years and people have gotten very indebted, if then a credit contraction comes and prices fall very much, then debtors will not be able to service their debt, and then they cannot pay back their loans, and then the banking system will go belly up, and then there will be, yeah, a huge depression. And this is what Hayek thought, that, yeah, in this case it would be okay if the government or central bank would intervene and stop the prices to fall and stop the credit contraction.

Well, Rothbard looks more positively on this scenario, and I agree with him, that for moral reasons of course it's better that the credit contraction runs its course, and also for economic reasons, because malinvestments are purged much faster if prices are allowed to fall. And it's true that there will be more bankruptcies, but hey, who knows what is the optimal amount of bankruptcies in any economy. Does Hayek know? Do I know it? No, I don't know it either. The optimal amount is the one where private property rights are respected, and when people cannot service their debts, then they go bankrupt. And that's it. Then there's just a redistribution.

**WOODS:** Yeah, so let me jump in and explain — make sure everybody's following this. The point is that even if some firms go under and they go bankrupt, there's no reason this has to be a disrupting force in the economy because the physical stuff they own still exists. It simply gets transferred to different owners in bankruptcy court. So that's what we mean by there's just a redistribution. The assets now get placed into what we presume to be more capable hands.

But what about the objection that — I know George Reisman has said this and a few other people — that bankruptcy courts tend to move very slowly, so maybe this process would be slow and agonizing and it wouldn't be as pleasant as you suggest when you say, oh, it would be just a bunch of redistributions? But if it's held up in the courts forever, then maybe it would drag everything down.

**BAGUS:** Yeah, of course there will be pressure to privatize the court systems so that it will be faster. Of course the government court system is very slow, so this is actually an argument to privatize justice and the court system, because then presumably it would be faster. But even if it takes some time to sort it out, if you think of the

company — let's say the company goes only bankrupt because it has debts and prices have fallen and the owner cannot service the debts. And we assume that the business model is actually a good one. It's actually viable. And the company goes only bankrupt because of the price deflation. Of course the new owner then will continue to run the company. And it's also in the interest of the old owner to continue to run the company. And if they think that now there's a time between the time the court needs to sort it out, it's in the interest of both that this company, whose business model is actually viable, continues to produce. So it's not in the interest of anyone to stop the production if the business model is viable. But of course there will be some friction — but then again, in any bankruptcy there's a friction, and who is to say which amount of bankruptcy is optimal? In the free market we will see what is the optimal amount of bankruptcy. No one can know.

**WOODS:** You know, in some ways you remind me of Guido Hulsmann, in that you have this ability to say things —

**BAGUS:** Because of the German accent.

**WOODS:** (laughing) Well, I was going to say (laughing) — it's not quite so superficial, but it's that maybe that accent allows you to get away with saying things that would shock most people, and you say them matter-of-factly, as if you're listing the ingredients in a lasagna recipe or something. Let's skip ahead to your chapter on where this all ends, how this all ends. Is it necessarily the case — doesn't it seem to be overstated to say that fiat money systems have to end badly, that they can't possibly be managed well? Is there a way — could you envision the present system, in the Western world at least, continuing in perpetuity? Or if not, why not?

**BAGUS:** I can't see it to continue in perpetuity. I think this actually depends on the ideas that people have. If people accept the system as it is, that we have fiat money and money monopoly by the government, then it can continue basically forever, but if people change their opinions, and I hope our book contributes to that, it can't. How could they do it, to continue with this system? It looks like we're going to a dead end, because we have such high debts, the governments all over the world are all in debt, that central banks have had to lower interest rates very low, even to negative rates. It does not seem that they could raise the rates again, because if they raise the rates to normal levels, the government would go bankrupt; the banking systems, it looks like they have to continue to print and print and print.

But there are many ways how they could continue in the system, reducing the over-indebtedness. They could do — I list several options. One of them is to do a one-time wealth tax and to use this money to pay down debts of governments and the banking system. There could be a bail in. Let me explain: a bail in is when the creditors of the banks bailed into the bank; that is, they are changed into shareholders. So instead of owning a bond that was issued by a bank, then you get the shareholder; that means the bank has less debts and more equity. And in this way, the banking system gets recapitalized and could stand bankruptcies or even a haircut on government bonds.

Or you can have the full-fledged monetary reform. You can have paper money that is basically at the end. For example, this happened after the Second World War in Germany. The old Reichsmark was basically useless. It was paper money at its end. But they did a monetary reform that was designed in a way that another paper money could be introduced, the Deutsche Mark. How did they do it? Basically they wrote down all government debts. They wrote down to one-tenths. They wrote down all monetary assets. They taxed away all profits that arose in this reform. When debts, for companies, for example, when the debts were reduced to one-tenths, this meant one-time profits, windfall profits for them, which were taxed away over 20 years, I think, completely. And the banks were actually recapitalized, because their government bonds were not written down, but they were given new government bonds.

So at the end of all these measures combined, we had resolved that the government was without debts, the German government; the banking system was recapitalized; over-indebtedness was reduced; and well, savers were basically expropriated. But the system was then on stable ground again. From there on the system could work again. It was like pushing the reset button on a computer.

And this is what they probably, if things get very ugly, they will try to do it again, and it is possible that when fiat money is running against the wall, do a monetary reform, which is like pushing a reset button, and start all over again. Of course it implies huge losses for the savers and the money users, but then they can try to start all over again. So it can continue in perpetuity; it depends if people let them get away with it.

**WOODS:** Well, Philipp, I want to recommend your book to the audience. *Blind Robbery: How the Fed, Banks, and Government Steal Our Money*. It is available of course from all the usual places: Amazon, and I'm going to link to it at [TomWoods.com/721](https://TomWoods.com/721). It has a very persuasive blurb on the back cover by a certain podcast host my listeners may be familiar with. It really is like a bucket of ice water over your head. But it's ice water that makes you smarter while it's hitting you. So I'm glad you did it, and I'm glad we're able to have this conversation, and I hope people will grab one, and best of luck. Thank you.

**BAGUS:** All right, thank you, Tom.