



Austrian Potpourri  
Guest: Joseph Salerno  
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**WOODS:** Joe, I was thinking of having a potpourri show with you just because you've been writing so many interesting items, and you've had videos on various topics, and I thought we might just share some of this information with the listeners. I already shared with them your blog posts this morning, or very recently, about the Fed bubblizing the economy once again. But let's start off a little bit far from home and talk about something that you wrote about last month, I think, and that's Argentina, which seems to be synonymous with inflation and monetary instability. Isn't it obvious to people that Argentina's problem is that their currency just keeps being inflated? Is there any controversy among economists as to what's happening or what the way forward for Argentina should be?

**SALERNO:** There's really no controversy among economists regarding what's happening in Argentina. Even economists like Joseph Stiglitz, who is a mainstream Keynesian, agrees that they've been inflating, and that this has led certain problems with the currency. There is a controversy, though, on the way forward, of course.

**WOODS:** So as an Austrian, of course, I can imagine what your answer would be in terms of the way forward, but maybe you might describe it all the same.

**SALERNO:** Yeah, sure, first of all, Argentina has attempted to implement a left-wing social welfare state in which prices are kept artificially low at the same time that spending is increased. And since it's very difficult to raise taxes, especially among the bulk of the population that are poor, they resort to the printing press. So over the past four years I think the money supply has increased by something like 30% per year, and inflation, that is, the increases in prices that resulted, was about 28% per year, though the government denies that and claims that last year, for example, prices only rose by 10%, which is high in itself, but it's also a lie. They rose by much more than that. Private economists have pointed that out. So the crisis that

came to a head last month was that the currency was being kept artificially low. In other words, it was kept cheaper than it really was, that is, the dollar was. So what would happen would be that they would say, look, we'll allow you to buy dollars for around seven pesos, but in fact prices had risen so much in Argentina that the price of the dollar had also gone up to around eight pesos. But they didn't allow it to rise, and the way they did that was to simply continue to sell dollars from the stock that the government owned to keep the prices of the dollar low so that import prices, when you imported goods from the United States, would be kept low, and this would keep the population happy and not too worried about the inflation.

**WOODS:** Back home in the U.S. on the issue of inflation it seems like if you raise inflation as an issue, then you know, so-called mainstream opinion will dismiss you, like, it seems to them that the past, well, six years have shown that concern over inflation, price inflation anyway, is misplaced because apparently the Fed can have unprecedented expansionary policies, and really we don't see much of an effect in consumer prices. So anybody who of all issues to be focused on is focused on inflation is really just missing the boat and not understanding that we've kind of moved on. That concern is so—you know, is so 1970s. What do we have to fear from inflation today? I ask you rhetorically, Joe Salerno.

**SALERNO:** Well, in fact, not only have they deemphasized inflation, they have been deemphasizing the dangers of deflation—that if we have too low of inflation, in other words, if inflation goes below 2%, or gets near 1%, we have to worry about possibly a fall in prices, which of course is a good thing for the American consumer, but that's beside the point. So they are continually raising this bogeyman of deflation to keep our eyes off inflation. Now, regarding the increase of consumer prices, there is, of course, manipulation of the statistics. So consumer price inflation is certainly higher than what the government is announcing, but even so it's not as high as you would expect. The key is that much of this new money is going into real estate. We're starting a housing boom again. It's going into the stock market. The stock market has hit new highs, record highs in the past year, and it's going into Midwest farmland. So we have what's called an asset price inflation. Since this does not hit the consumers directly in their pocketbooks, the Fed is not worried about this kind of inflation, but this kind of inflation is what brings about financial crises, as we saw with the housing bubble in 2000 that ended in 2006-2007.

**WOODS:** You know, Joe, somebody like Larry Summers is a real dove when it comes to inflation. He's not really worried about it. We don't have to be worried about it. There doesn't seem to be much of a problem with monetary inflation these days. It actually has solved some of our problems and this and that, but in the same breath he'll say: but you know what's funny? Gosh, over the past 30, 40 years, it's like our economy has been characterized by one bubble after another. Hmm, I wonder about that. I guess that has no cause.

But couldn't it be that in addition to the obvious problems with monetary inflation, which would be that the widow getting her pension check doesn't have the purchasing power she used to have, isn't it also that it feeds into bubbles?

**SALERNO:** Absolutely. Again, they want to act as if bubbles are something, almost an act of God, an act from on high. You don't see the causes. The mainstream textbooks don't explain what causes bubbles. The most they say about it is that, well, a lack of regulation can cause bubbles to get out hand, and a lack of regulating the financial system had something to do with the bubble that was created at the midpoint of the last decade, but they don't go any further than that. They have no fundamental theory about what causes bubbles as the Austrians do.

**WOODS:** Today when we look at economic conditions, obviously the economy is still very fragile. There is certainly no robust recovery on the horizon. But one thing that people would say, especially those who are not sympathetic to the market as you and I are, is that if you look around at the sort of jobs people are getting, it seems like things have changed from where they were in the 1990s, or the 1950s, when you'd go to college, and then you'd get out, and you'd get a good job, you'd be on a good career path—you play by the rules, and everything works out for you. Whereas today people are barely getting by with part-time jobs, or temp jobs, and everything looks like a dead end to them. How do we account for this in a way that doesn't indict the free market?

**SALERNO:** Well, that's a very good question, and it has a very good answer, and I think that answer was given a number of years ago in an article and book by Robert Higgs, and that is that there is something called regime uncertainty. People, especially investors and business decision-makers, are so uncertain about the future that they are loath to make long-term investments—investments in factories and equipment—and in a permanent labor force to operate these factories and so on. We see the reasons for it. The huge debt. No one is sure by how much taxes are going to be raised in the future to reduce deficits and to keep the debt under control. We also have the unknown costs of Obamacare coming up. Firms are extremely worried about these costs and what it's going to do to their labor costs, so again, they are holding off rationally on hiring permanent workers, or on hiring full-time workers that they'll have to give health benefits to.

**WOODS:** I know a guy that runs a chain of thrift stores, so on the one hand thrift stores are, in this sort of economy, probably doing relatively well in terms of people coming in and buying stuff, but his problem is certainly he doesn't want to expand right now because he's worried about the increase in the minimum wage. Look, being a cashier in a thrift store is not meant to be a long-term career. It's not meant to earn you a whole lot of money. It's meant to be the first rung on the ladder. So he's afraid of that. He's afraid of Obamacare, and so as exactly as you say, he is holding back on it. He's holding back on all this.

Now I want to ask—when we get back from the break because we have a break coming up in a few minutes, I want to ask a question that will require a longer answer. So I want to shift gears and give you something we can fit in before the break. You did a video not long ago on the issue of income inequality that's allegedly growing and is supposed to be a big problem. How did you sort out the truth from the falsehoods, and the proper interpretation of it?

**SALERNO:** Well, what I tried to do is to go back to the basic principles, and the basic principles of the market is that there is no distribution, per se, on the market. All there is is production and exchange. I think the example I may have given in that video is, if I hire a babysitter at \$10 an hour for 20 hours a week, well, then she produces the 20 hours of babysitting services, and I gave her 10 hours, \$10 per hour, so I give her \$200, so there's production, and then she exchanges those services for the money. There is no distribution. There is no third party up there distributing income, deciding who gets what. It's simply the result of all the exchanges in the economy. And what I pointed out was that that all changes when the government comes in and begins to tax people's incomes that they earned on the market. At that point, when the government begins taxing, it's going to spend, and it's going to spend or also subsidize, and that's going to distribute income that's already been earned, and that is the problem.

**WOODS:** Joe, just the other day I was re-reading *Power and Market* by Murray Rothbard, and he made a point that I must have missed the first time I read that book, but it's so beautiful. It's just what you just said, that sometimes we use this term redistribution of wealth. The government is redistributing wealth. But Rothbard says that's not quite right because redistributing gives the impression that it was initially distributed, and now we're going to redistribute it. But no, there was no distribution in the beginning. There is no mechanism of distribution on the free market. There's just exchanges. There's just buying and selling. That's all there is. There is no guy with a big sack of boxes and dollar bills who goes around and hands it out to people. So when the government gets its hands on our money and gives it to other people, it's not redistributing, it's distributing. There was no distribution process to start with.

Joe, I warned you this was going to be a potpourri episode, but that's your own fault for writing about so many different topics. I want to ask you about the subject of the bank run, because sometimes we hear Austrian economists clapping with glee at the prospect of a bank run. I will get to the glee aspect in a minute, but first I want to ask you: is a bank run really possible in the age of the FDIC? Short of a system-wide collapse or something, is a bank run really possible?

**SALERNO:** Yeah, actually there is a sort of a new-era bank run. With the FDIC, of course, deposits are protected up to \$100,000 per account, but the FDIC even bails out those who have more than \$100,000, and it has done so in the past. However, there's another avenue by which bank runs have been taking place since the financial crisis, and that is there are lenders to banks of people who buy banks' commercial paper, basically, a promise to pay the people back in three or six months. There's also repos. A repo is simply an exchange where a bank gets money from a lender in exchange for a security, which is collateral. These are not covered by the FDIC. When these people begin to sell this commercial paper or not renew it when it comes due, the banks then run short of funds, and when they run short of funds, they no longer can finance the continuing borrowing by their business clients, and also they have to begin to sell off some of their corporate bonds and so on, so you get a fall in the prices of all these assets. You get businesses unable to borrow, and then this has sort of a chain or domino effect and other banks become implicated in the process. So you get a sort of a bank run where bank paper or bank

promises to pay back people that are not covered by insurance begin to be turned in, begin to be not rolled over. People don't continue to loan money to banks. So banks can't finance all their assets, and you have a collapse in the prices of these assets, and that leads to a financial crisis.

**WOODS:** Now, okay, so that's different from the typical sort of bank run that we're accustomed to that the bank has just lent out more than it should have, and then the people come demand the money. But let's imagine that old-fashioned type of bank run because sometimes when I talk to really hard money Austrians, they'll say things like the bank run is—Rothbard said this, and he's not alone—the instrument the people have to keep the banks honest. We need the bank run. Instead of demonizing it, we ought to cheer it. Now, I understand the idea of the bank run is that it's supposed to hold the bank in check to prevent it from being grossly irresponsible with people's money. But why wouldn't I, as the average American, favor a system in which, okay, maybe the banks are 25% riskier with the way they handle the money than they would otherwise be, but you know what? I want the security of FDIC. I don't care if that means my bank is a little riskier. I bear no risk. It takes all the risk all off me. Why would there be anything for me as the average American to be concerned about? I've got the FDIC.

**SALERNO:** Well, that's a great question, Tom. There's a couple of things to be concerned about there, and that is number one, when the banks have this safety net of the FDIC and of the Fed bailing them out, they make imprudent loans, and that means that resources are misallocated. The wrong things are produced, and as a result of that over time we get a recession. So that can be a readjustment. So you as the average American suffer from the recession. You always suffer from the fact that, look, inflation in the modern world occurs through the banking system, through fractional-reserve banking. So, again, as the average American consumer, you suffer from ongoing increases in prices. So this would restrain the banks from really planting the seeds by inflating that would later lead to a recession. So if you had a system where there was no central bank and no federal deposit insurance, what you would find is that banks would be very, very wary of lending a lot of money out. They would keep very high reserves. In fact, they might stop lending altogether, and the only way they would lend is if people were willing to leave their money there for three months, or six months, or a year by buying certificates of deposit. So in other words, the deposits that you use every day, your checking account deposits, would not be loaned out. I think that is a system that is a sound system and that would naturally arise if you got rid of the bank's safety net, which brings about this moral hazard that, you know, the banks, look, I am getting bailed out. My customers know that, my depositors know that, so I am just going to lend money to very risky ventures if I can make a big profit. We don't want those types of things happening.