Crew: About ready, Bill?

Bill Walton: I am ready.

Crew: Please, stand by, all right, [crosstalk 00:00:03]-

Bill Walton: I've been learning how to use this teleprompter.

Sarah: Should I start?

George Selgin: Oh, you use-

Crew: Yeah, start it when [crosstalk 00:00:06]-

George Selgin: ... the teleprompter now.

Bill Walton: Well, it's right there.

George Selgin: I see, yeah.

Bill Walton: I've got it here, and I don't quite have Obama's skills yet.

Norbert Michel: I'm sure you'll get it, Bill.

Bill Walton: Not that I really would want to.

Crew: Bill, may or may not have mentioned this, [inaudible 00:00:24]. You're in conversation-

George Selgin: Right.

Crew: ... except for the very beginning, where he's basically talking to the viewer.

George Selgin: Yeah.

Crew: He'll just do that and transition to [inaudible 00:00:33].

George Selgin: Okay.

Bill Walton: Yeah, it's good.

Crew: Sarah, are you ready with the timer?

Sarah: Yes, I started-

Crew: Oh-

Sarah: ... [crosstalk 00:00:43].

Crew: Yeah, sure.

Sarah: Should I start it back again?

Crew: No, it's okay.

Sarah: Okay.

Crew: That's close enough.

Bill Walton: Okay.

Crew: Ready, Bill?

Bill Walton: I'm ready.

Crew: Here we are, wait 'til it gets up near the top. Here we go.

Bill Walton: I want to talk today about something important to all of us, our money. Specifically, I want to talk about the institution and the people primarily in charge of America's money, the Federal Reserve.

Bill Walton: The Fed has been in the news a lot, most recently, about the controversy over President Trump's nominees to the Federal Reserve Board of Governors. This debate has raised a lot of other issues like modern monetary theory, linked currency systems, the global asset-price inflation, the Fed's independence, negative real interest rates, turning banks into regulated utilities, quantitative easing, and the Fed's goal to create inflation, when I thought it was supposed to support sound money.

Bill Walton: Well, if you're like me, your eyes glazed over listening to this list. But, I think we need to understand some of what is happening with our money, and what the Federal Reserve is up to. With me to sort this out are two of the smartest monetary economists we have. Norbert Michel is the director of the Heritage Foundation's Center for Data Analysis, where he specializes on issues pertaining to financial markets and monetary policy, Norbert.

Norbert Michel: Bill, thank you.

Bill Walton: George Selgin is a senior fellow and director of the Center for Monetary and Financial Alternatives at the Cato Institute and professor emeritus of economics at the University of Georgia. George, welcome.

George Selgin: Nice to be here, Bill.

Bill Walton: Well, let's dive right in. The Federal Reserve, it's been with us a long time, since 1914. What was life like before the Federal Reserve, and why was it created?

George Selgin: Well, life wasn't that great. We had series of bad financial crises culminating in the big crisis of 1907, the Panic of 1907. The Federal Reserve ultimately grew out of that panic, which made everyone realize that we had to have reform.

George Selgin: Most people assume that, therefore, it was a good solution and a necessary solution and a successful solution to the problem of panics, at least, that has been the conventional wisdom. It's a little bit hard to maintain these days in light of our having had such a bad panic before.

George Selgin: But, what a lot of people don't understand is why we had those panics before the Fed. That's really important, because it wasn't because the government didn't regulate the monetary system before 1914. On the contrary, if you delve into the causes of those panics, you find bad government regulations of the monetary system, that preceded the Fed's establishment, that we're absolutely crucial to the problems of that period. That's what people should be aware of in-

Norbert Michel: It's not-

George Selgin: ... discussing-

Norbert Michel: ... that we didn't-

George Selgin: ... the Fed.

Norbert Michel: ... have a central bank.

George Selgin: Yeah, the justification of the Fed was that we needed to do something, and that was correct.

Bill Walton: Well, the people who-

George Selgin: But-

Bill Walton: ... said we needed to do something were the New York banks [crosstalk 00:04:01]-

George Selgin: Well, that was, they-

Norbert Michel: That's part of the [crosstalk 00:04:02]-

George Selgin: ... shaped the reform effort. You had people who had excellent ideas about how to fix the monetary system in the years leading 1914, most of whom looked at Canada as a good model for what the US system should have been like.

George Selgin: What they had in Canada was a decentralized system, not as decentralized as ours though, because they let their banks branch more than 100 years before we started letting ours branch. They had about 40 banks that had branches all over the country, and they were remarkably stable. They had no crises.

Bill Walton: To be clear, when a bank, you have a headquarters, and then you have all the branches. If you have a lot of branches, you have a much more stable deposit base and a bigger lending book. You can diversify the lending-

George Selgin: Exactly.

Bill Walton: ... over a bigger portfolio, and so it's a lot more stable.

George Selgin: A lot more stable and funds, when they're needed, can move from one-

Norbert Michel: Move.

George Selgin: ... part of the country to another just by moving-

Bill Walton: Yeah.

George Selgin: ... from one branch-

Norbert Michel: In that bank.

George Selgin: ... of the bank-

Norbert Michel: Within the-

George Selgin: ... to-

Norbert Michel: ... bank.

George Selgin: ... another.

Norbert Michel: Yeah.

George Selgin: Yeah.

Bill Walton: Well, I had job... As a young banker, I was head of strategic planning at Continental Bank in Chicago, if you remember that.

Norbert Michel: Continental?

Bill Walton: We had a little problem-

Norbert Michel: There was a-

Bill Walton: ... with Continental-

George Selgin: Yes.

Norbert Michel: Yeah.

Bill Walton: ... Bank.

George Selgin: Yeah.

Bill Walton: But, Continental-

George Selgin: [crosstalk 00:05:25]-

Bill Walton: But, Illinois at the time was still a unit banking state-

George Selgin: That's right.

Bill Walton: ... which meant you can only have one-

Norbert Michel: One-

Bill Walton: ... one office. I guess we could have one other one. We had a branch about a mile away.

Bill Walton: Continental was very big in oil and gas lending when oil prices were $70 a barrel. When they fell to $14 a barrel, it was a big problem. Its deposit base was, I think we had assets of 45 billion, and $35 billion was borrowed from the Japanese overnight.

George Selgin: Incredible.

Bill Walton: As soon as things got bad, they withdrew their money, and the bank went right out. That's the kind of thing that drives a bank out of business, when you don't have a branch banking system.

George Selgin: Absolutely.

Norbert Michel: That's right.

George Selgin: If you don't have the opportunity to diversify, both on the asset side and the liability side, you've got weak banks. We had 30,000 tiny, mostly tiny, weak banks before the Fed, so we had structural problems. But, they could have been directly solved with deregulation. Instead, it was a patch job done, which was the Fed, where the Fed was supposed to make up for these structural deficiencies, which it never has done very well.

Bill Walton: Well, just, one of the things, I think, it's hard to conceive of life without the Federal Reserve in America, or all the central banks in Europe and Japan, et cetera, but there are alternatives. I've been reading about what your work has been. There's something called free banking, which is where you don't really have a central bank, but you have a widely diversified group of banks, and each one of them issues notes and that sort of thing. I think the Scottish had a very successful system.

George Selgin: They did, indeed, very stable, very few losses to their customers or the banks, no crises. The comparison between Scotland and England, which England, of course, had one of the oldest central banks, the Bank of England, but the comparison between those systems and that between Canada and the US, very similar.

George Selgin: In Canada, Scotland, you had free banking, decentralization, no central bank, and you had stability. In England and the United States, you had regulation. In England, you had a central bank before, long before 1914. In the US, you had other kinds of very severe restrictions on banking freedom. In both of those cases, you had tremendous instability.

Norbert Michel: One of-

Bill Walton: This-

Norbert Michel: ... those-

Bill Walton: Jump in-

Norbert Michel: One of-

Bill Walton: ... please.

Norbert Michel: ... those conventional critiques is that you had these competing banks with these competing notes, and so it was chaotic, and nobody could understand what was going on, because they all these different types of money. That actually isn't true. George's work has been better than anybody's in showing that, that part of the system actually functions-

George Selgin: In those-

Norbert Michel: ... okay-

George Selgin: ... free systems-

Norbert Michel: ... in those-

George Selgin: ... not in the-

Norbert Michel: ... free systems.

George Selgin: ... United States, where they had [crosstalk 00:08:17]-

Norbert Michel: No, that's right.

George Selgin: ... branch-

Norbert Michel: Right. In those free systems, yes.

Norbert Michel: Then, now, with technology, especially the way it is, it would be nothing for anybody to have customized prices in any custom, or, I'm sorry, any currency that they want. If you shop on Amazon, Amazon can tailor the prices that you see much better than they could have done in that era.

Bill Walton: In theory, we could have something like this, if we had the political will or desire to do that.

Norbert Michel: Well [crosstalk 00:08:49]-

George Selgin: Well, it's a little tricky now, Bill, because those systems could rely on not having, didn't need a central bank, because they had a defined monetary unit, defined in terms of gold or, you go further back, silver. That unit, of course, had an existence. It didn't depend on any public institution.

George Selgin: In order to have something like that today, you'd either have to somehow re-establish a metallic or independent monetary unit, independent of any institution, or you would have to build a free banking system on the present fiat dollar. There are ways to do that, where you rely on the flexibility and capabilities of the commercial banks, once they're given freedom to do what they're capable of doing, to allow the Fed's power to be dramatically reduced and, basically, have it operate like a little machine, that just controls a very stable base for the other reserve banks to use as reserves.

Bill Walton: The reason we're having this conversation is we want to talk about how the Fed has done since 1914, and why maybe it's not getting straight As on its report card. When it was formed, and I'm referring I think something that, George, that you wrote that was, number one, three things: promote effectively the goals of maximum employment, stable prices, moderate long-term interest rates, and then, also, overall, to contain financial disruptions and prevent their spread outside the financial sector.

Bill Walton: 1914 have the Federal Reserve, and then, how did things-

Norbert Michel: That hasn't-

Bill Walton: ... go?

Norbert Michel: That hasn't worked out-

Bill Walton: Tell, tell-

Norbert Michel: ... so well.

Norbert Michel: We've got one of, in the developed world, we've got one of the worst track records in financial stability of any country, just at a higher level, so we've had more banking crises than most. George has done a lot of work on this as well, but Charles Calomiris is another. It's well documented.

Norbert Michel: Since 1970, we're one of only two developed countries, or one of only three developed countries, two developed countries that have more than one banking crises. Sorry.

Bill Walton: Mm-hmm (affirmative).

Norbert Michel: Just from a banking stability standpoint, that hasn't worked out.

Norbert Michel: Most of, a lot of the work that George has done is looked at a lot of the macro results, if you will. Could you say that the Fed has stabilized the business cycle? Could you say that it has moderated prices or helped the price stability? Well, you can only say that about price stability, if you have the Fed's definition of price stability, which is constant inflation.

Norbert Michel: In terms of taming the business cycle, there's more than enough reason, more than enough evidence to say that they really haven't done such a good job on that either.

George Selgin: Mm-mm (negative).

Bill Walton: We talked about inflation. You mentioned inflation. Now, we went through horrible inflation in the late '70s, early '80s. Their mandate is to promote stable prices, and George, you had a chart in one of your presentations of what prices look like from 1790, roughly 100 years before the Fed was formed. It was fascinating how much prices rose.

George Selgin: In the days when you had a gold or silver standard, the price level couldn't wander very far, before there would be responses from the, ultimately, from the gold mining industry, that would check the movement in the price level and, ultimately, help it come back to where it came from.

George Selgin: The result, a natural result of a metallic monetary standard was long-run price stability, meaning, literally, that in the long run, you could expect the price level, that is the general cost of goods, to come back to wherever it had been in the past. That's exactly what happened if you go by the best available statistics. The price level on the eve of the Fed's foundation was roughly what it had been 140-

Bill Walton: I think your-

George Selgin: ... years before.

Bill Walton: ... chart said prices were up 8%.

George Selgin: There was a trivial-

Bill Walton: That's-

George Selgin: ... difference.

Bill Walton: ... not 8% annual, that's 8%-

George Selgin: No, 8% in-

Norbert Michel: [crosstalk 00:13:25]-

Bill Walton: That just what's happened-

George Selgin: ... 130 years.

Bill Walton: ... when we started and ended the series.

George Selgin: That's right. That's a long-run result of having a precious metal standard.

George Selgin: Of course, we have to remember that, for its early decades, the Fed was still bound by the gold standard. But, the question is, did things become relatively more stable given that continuation of the gold standard, than they had been before? The evidence is, they didn't become more stable.

George Selgin: Despite all of the problems that I was alluding to before about the pre-Fed system, because, again, I can't emphasize enough what a flawed system that was. The Fed has done a dismal job even improving on that system, particularly during the Fed's first decades, which were notoriously-

Bill Walton: You call-

George Selgin: ... bad.

Bill Walton: You call the decades from 1914 to 1945-

George Selgin: The practice period, the Fed's practice... Well, the reason I do that-

Bill Walton: I took them 30 years.

George Selgin: Yeah. I do that on purpose. I have this study with my former UGA colleague, Bill Lastrapes, and Lawrence White from George Mason, where we very carefully compare the available evidence on all the commonly accepted criteria of the Fed's performance. We compare that performance with the performance of the pre-Fed system with all its flaws. What we find is, first of all, if you include those decades, those first decades up through World War II, it is so patently obvious that the Fed has not improved things, that it almost seems a little bit harsh to point it out.

George Selgin: What we did was we said, "All right, let's cut them a little slack," because they've got to get their sea legs and all that, and let's leave out the Great Depression and World War II and World War I and the inflation after World War I. Let's just leave that out and make these same comparisons about unemployment, the price level stability or predictability, number of cyclical fluctuations, number of crises. Let's do that, just compare the post-'45 period with those decades before the Fed, including things like the panic. We didn't take out the Panic of 1907, but we took out the Great Depression. The Fed, in that case, the Fed doesn't look a lot worse, but it doesn't improve things very much.

Norbert Michel: It's not a lot better.

George Selgin: In some respects things are, still, even that way, the Fed comes out as inferior.

George Selgin: This, I think, is reason for people to ask, "Can't we do better than this?"

Norbert Michel: Basically, you have the one period, the period that you alluded to in the early '80s, it's come to be called the Great Moderation, and if you take out that period, then the Fed's track record is-

Bill Walton: [crosstalk 00:16:17]-

Norbert Michel: ... really bad.

Bill Walton: That's when Paul Volcker came in and took 18% rates down to-

Norbert Michel: Inflation came down.

George Selgin: It's actually, yeah, well, it actually, the Great Moderation starts with Paul Volcker-

Bill Walton: Yeah.

George Selgin: ... depending on when you date it, but it continues virtually up until the Great Financial Crisis. It's a fairly long period when there was considerable stability, but it was unique. It was unique. It was one of these eras, there are a couple of them, and the '20s look like another one, when the Fed's performance looks pretty good. But, then, you have all these other periods when bad things are happening.

Bill Walton: Well, one of the... The thing that's fascinating now is that most of us think of the Fed, and I don't anymore, now that I've done all the research, kind of think of the Fed as this omnipotent institution filled with geniuses that can gently guide us through economic good times and bad times. It absolutely has, that has not been the case.

Bill Walton: It also has been given responsibility to do a lot of things that any Federal Reserve or any central bank is not equipped to do like maintain employment. What would a Federal Reserve have to do with maintaining low unemployment? How does that-

Norbert Michel: Well-

Bill Walton: ... work?

Norbert Michel: ... and what's interesting about that one too, is that their own statements say that at maximum employment, in the long run, it has very little to do with monetary policy. That they have, they can't really do much about it.

Bill Walton: Okay, so, they're saying, "Don't grade us on that curve."

George Selgin: Well, that's-

Norbert Michel: Yeah, partly.

Bill Walton: Yeah.

George Selgin: The truth is, and I think everyone recognizes this, that the Fed, any central bank is capable of causing a lot of unemployment if they botch things up. In a sense, we should want the Fed to care about unemployment, at least to the extent of caring about not doing things that cause more of it than is necessary. I think that has to be considered one of their responsibilities.

George Selgin: Where things get dangerous is when people expect the Fed to be able, not only behave responsibly enough to not contribute to unemployment, but to be able to solve and eradicate all unemployment problems-

Bill Walton: Mm-hmm (affirmative).

George Selgin: ... no matter what their ultimate source is. That's when you get into trouble. Because, you start having people look at the Federal Reserve as having the power, not only to keep things reasonably stable, so that it doesn't contribute to unemployment, but, also, to-

Norbert Michel: To-

George Selgin: ... get everybody-

Norbert Michel: To get a-

George Selgin: ... a job.

Norbert Michel: ... a job, yeah, yeah.

George Selgin: That's asking more from monetary policy than it's capable of achieving. Unfortunately, there's always pressure on the Fed to do that, because people believe it has the power to-

Bill Walton: Mm-hmm (affirmative).

George Selgin: ... do anything.

Bill Walton: Mm-hmm (affirmative). Well, let's come to more recent history, 2008, 2009. What did the Fed do before that period, and then, how did they behave during the crisis, and how would you have done it differently?

Norbert Michel: Oh, wow. On the technical side, what did they do? Or, just-

Bill Walton: Well, whatever-

Norbert Michel: ... whatever happened?

Bill Walton: Just explain it to-

Norbert Michel: Well-

Bill Walton: ... somebody who hasn't spent as much time as you have working through all the math.

Norbert Michel: Part of their mandate is, to sort of, to dovetail off of what George is saying, is to not screw things up. If you're on the Fed Board, you don't want a major depression. You don't want a major recession. You don't want to crash the economy. If the economy's crashing all around you, the last thing you want to do is tighten the money supply, so to speak, so that nobody can get any funds.

Bill Walton: Mm-hmm (affirmative).

Norbert Michel: That's going to make things worse. That's what happened in the Great Depression. That's what Ben Bernanke apologized to Milton Friedman for at an American Economic Association conference.

George Selgin: Not that the Great Depression was Ben Bernanke's fault.

Norbert Michel: Not that it was his fault, but then, when Ben Bernanke was-

Bill Walton: I thought we blamed everything on him.

Norbert Michel: Almost-

Bill Walton: Almost.

Norbert Michel: ... but not everything, no.

Bill Walton: But, when did he, what year did he apologize to Milton Friedman?

Norbert Michel: Oh, that was in the-

George Selgin: Friedman's birthday around 1999.

Norbert Michel: ... '98? '99.

Bill Walton: Okay.

Norbert Michel: Then, when Ben was running the Fed, they did almost exactly the same thing. There's good evidence, we've documented this. I've got some papers on this. George has some papers on this. That at the beginning of the financial crisis in 2008, when the Fed should have been increasing more liquidity into the system and flooding the system with liquidity, they tightened at exactly the wrong time. That, almost definitely, I would say definitely, worsened the crisis and made things, prolonged things.

George Selgin: We tend to forget that for many, many decades after the Great Depression, no one thought that the Fed had been to blame for it. It was only when Milton Friedman and Anna Schwartz published their Monetary History of the United States in 1963, that they changed the perception of what the Fed had done during the '30s to the modern one, where we recognize, Ben Bernanke recognizes, that the Fed had really done a bad job.

Bill Walton: Mm-hmm (affirmative).

George Selgin: I think that that kind of thing may happen again. Right now, it's still too early, and you still have the narrative where Bernanke's Fed, in this case, came to the rescue and did everything that could be done right. But, I believe, as time passes, it will become more and more evident that the Fed, that the Great Recession was, to a considerable extent, another Fed botch job.

George Selgin: Norbert mentioned the over-tightening. But, of course, we shouldn't forget, that in the years leading up to the financial crisis-

Norbert Michel: Oh.

George Selgin: ... we had, of course, a tremendous housing bubble. There is considerable evidence that the Fed's policies were too loose and contributed to that bubble. It's controversial, but, I think, if you look at the statistics, it's pretty clear that the Fed contributed something. It's hard to say exactly how much.

Bill Walton: Mm-hmm (affirmative).

George Selgin: Then, as Norbert was saying, when 2008 came along, what you had was the opposite error of over-tightening, and that's the part that resembles the Fed's misconduct in the early 1930s. Here, it must be said, that proponents of absolute, maintaining an absolutely stable price level contributed to that on the Fed, the hawks, and I've written about this. You wanted me to be controversial, so I'll get in trouble with-

Bill Walton: Oh, yeah, we'll-

George Selgin: ... some people now-

Bill Walton: Let's do that.

George Selgin: Okay.

Bill Walton: Yeah.

George Selgin: Because, there are circumstances when you really don't want the Fed to try to act to prevent prices from rising, and the summer of 2008 was one of them. There was a big increase... It was not a big increase, but there was a, inflation was creeping up 4% and then above. It was all driven by oil. It was all a commodity supply shock.

Bill Walton: Mm-hmm (affirmative).

George Selgin: That's exactly the sort of thing that you don't want to tighten.

Bill Walton: Mm-hmm (affirmative).

George Selgin: You don't want to tighten [inaudible 00:23:51]. They should have ignored it. Instead, they were so obsessed about avoiding-

Norbert Michel: The inflation target.

George Selgin: ... 4% inflation, that they decided that they were going to keep money tight, by hook or by crook. This is just banks are starting to get in trouble and fail, and they even did something called sterilizing their lending, so, they were creating reserves by emergency lending.

Bill Walton: Oh, here's another one of those terms.

George Selgin: Terms, but I'm going to-

Bill Walton: We're-

George Selgin: ... explain it.

Bill Walton: ... sterilizing. We're going to make this sexy.

George Selgin: I'm going to. They're making loans to banks, financial institutions that are in trouble, but... That creates more reserves, because the Fed's expanding its balance sheet, so it's making loans, and the result of this is that there are more dollars-

Bill Walton: And, they bought-

George Selgin: ... in the system.

Bill Walton: ... massive amounts of junk mortgage paper.

George Selgin: That's later.

Bill Walton: Okay, oh-

George Selgin: That's-

Norbert Michel: That's-

George Selgin: ... right.

Norbert Michel: ... later.

Bill Walton: ... okay.

Norbert Michel: [crosstalk 00:24:44]-

George Selgin: We'll get to that. That's after 2009.

Bill Walton: First, there was the bailout.

George Selgin: First, there's-

Bill Walton: ... Then, there was-

George Selgin: ... the bailout.

Bill Walton: ... the junk, okay.

George Selgin: First, there's the direct emergency lending to the-

Bill Walton: Yeah.

George Selgin: ... financial system. But, to offset the reserve creation that, that normally would involve, the Fed is selling securities. It's engaging in security sales in late 2008, not purchases, to offset its lending. All of which is aimed at trying not to let the inflation rate stay above 4%.

George Selgin: In the meantime, we know now that the economy had been in a recession, according to the NBR, since January of that year or December-

Norbert Michel: December '07.

George Selgin: ... 2007.

Norbert Michel: Yeah.

George Selgin: They're tightening money or keeping it tight, worrying about inflation, when the economy's going down the toilet.

Bill Walton: Well, one of my core beliefs is this notion that decisions are made best right at the level of where the action is. The further you pull back from the front lines in whatever, whether it's business or military or whatever, the less good information you have, and the less [inaudible] it is to adapt to what's happening.

Bill Walton: We have a free banking system with banks with all of their branches. They can deal with that problem. Let's say you got a problem in Ohio. Ohio will deal with that, but it's not going to affect New Jersey.

Bill Walton: Here's the Fed, beautiful offices on Constitution-

Norbert Michel: Constitution, right off Constitution.

Bill Walton: ... what's the Fed's dashboard look like? You're sitting in an office in the Federal Reserve, and we're talking about things like this, how clearly can they actually see what's going on?

George Selgin: That is a huge problem. They have a gigantic dashboard, but it's so big, that it's like some of these high-tech fighter planes, where the capacity of the fighter plane's beyond the-

Bill Walton: Could I envision it in a Pentagon war room?

George Selgin: That's right.

Bill Walton: Or-

George Selgin: It's-

Bill Walton: ... Dr. Strangelove?

George Selgin: ... beyond the capability of a human pilot to actually handle all the knobs that are-

Bill Walton: Okay.

George Selgin: ... in front of him.

George Selgin: But, this gets to a point that I wanted to make in criticizing the Fed about its conduct in 2008 or in 2005 or in any other time, we have to be careful. It's one thing to say, "Look how they screwed up." Another to suggest that if only the right people were-

Norbert Michel: Right.

George Selgin: ... there, and they had the right dashboard, that they could have done it right. This is an institutional problem.

Bill Walton: Exactly. It's not-

George Selgin: This is, this is, you can't do this.

Bill Walton: Yeah.

Norbert Michel: Right.

George Selgin: No one can be a good central banker.

Bill Walton: These are not bad people. These are not dumb-

Norbert Michel: No.

Bill Walton: ... people.

George Selgin: They're very-

Bill Walton: These are good people.

George Selgin: Yeah.

Bill Walton: They're well-intentioned people-

Norbert Michel: That's right.

Bill Walton: ... but, structurally, you can't know all the things-

Norbert Michel: We have-

George Selgin: Exactly-

Norbert Michel: ... them set up-

Bill Walton: ... you need to know to make-

Norbert Michel: ... to do something-

Bill Walton: ... these changes.

Norbert Michel: ... that is impossible.

George Selgin: That's right.

Bill Walton: When we're talking about criticizing-

Norbert Michel: Yes.

Bill Walton: ... the Fed-

Norbert Michel: Yes.

Bill Walton: ... we're not talking about people.

George Selgin: That's exactly right.

Bill Walton: We're talking about the system that's being operated.

Norbert Michel: That's right.

George Selgin: Because, if you're talking about people, you get into the fallacy that oh, if we just put the right people on the board, then everything will be fine, and the institution will run-

Bill Walton: Well, that would have been true-

George Selgin: ... well.

Bill Walton: ... had we gotten Steve Moore.

George Selgin: Well, we can talk about that.

Bill Walton: Okay.

George Selgin: But, it is an institutional problem. It's trying to centrally plan what we are not capable, and no one is capable of centrally planning.

George Selgin: It is the case that a free banking system does, can do a lot to handle these problems itself, partly, because it's a more robust system, so financial crises are simply less likely to happen and to drag down the system with them. But, also, because, the decentralized banks do have better local signals about where there are changes in-

Bill Walton: Mm-hmm (affirmative).

George Selgin: ... demand for money-

Bill Walton: Mm-hmm (affirmative).

George Selgin: ... that need to be compensated about the circumstances that call for more or less credit creation.

George Selgin: Mistakes by free banks don't matter as much, because they're not all acting the same way.

Bill Walton: Well-

George Selgin: You have independent errors. You don't have one big error driving the whole system.

Bill Walton: Well, one of the things I think that caused the crises, the mortgage crises was this notion that we were beginning securitize, package and securitize mortgage loans.

George Selgin: Absolutely.

Bill Walton: When I was a baby banker, you had a business where you knew who you were lending to, and you also knew whose deposits you were taking, and you were in the same institution. You could also know what was going on in this neighborhood or that neighborhood, and make adjustments accordingly.

Bill Walton: We started packaging these into securities, the people originating the loans didn't have any idea where it was going to go, and the people who owned the paper didn't know what was happening with the underlying mortgages.

George Selgin: Absolutely. This was a big problem, securitization. Of course, that raises the question of the role of the GSEs, of Fannie Mae and Freddie Mac.

Norbert Michel: And, ultimately, the federal-

Bill Walton: GSE-

Norbert Michel: ... government.

George Selgin: Ultimately-

Bill Walton: ... government-

Norbert Michel: Government-

Bill Walton: ... sponsored-

Norbert Michel: ... sponsored-

George Selgin: Sponsored-

Bill Walton: ...enterprise.

Norbert Michel: ... enterprise.

George Selgin: ... enterprises. That's right-

Bill Walton: Okay.

George Selgin: ... because we want to be careful in pointing out the errors of the Fed, and how they contributed to the crisis, to not suggest that there weren't other factors involved, including other government agencies that-

Norbert Michel: Mm-hmm (affirmative).

George Selgin: ... that contributed to the developments that led to that disaster.

Bill Walton: Yes, yeah.

George Selgin: The GSEs certainly belong on that list.

Bill Walton: But, one of the things that I'm, [inaudible 00:30:08], understand better is I thought the Fed was built to promote sound money and stable prices, and we were not... That inflation was basically a way to rob your children of the future and to borrow money that you otherwise wouldn't borrow in the capital markets.

Bill Walton: Yet, they have a standard of 2% inflation, which means... I don't know how quickly the money loses half its value, but it's pretty-

Norbert Michel: Quickly.

Bill Walton: ... it's pretty rapidly.

George Selgin: It's 70, 70-

Norbert Michel: Seven years?

Bill Walton: Where did 2% inflation-

George Selgin: I'm sorry 35 years, 36 years.

Bill Walton: Okay. Where did having 2% inflation become a good thing?

Norbert Michel: Well, some would say it's not a good thing.

Bill Walton: Well, I would say it's not a-

Norbert Michel: But, yeah.

Bill Walton: ... good thing.

Norbert Michel: Yeah.

Bill Walton: But, when did the Fed... I heard that something about New Zealand-

Norbert Michel: They didn't-

Bill Walton: ... started this.

Norbert Michel: Well, we didn't have an inflation target, a formal, formally we didn't have an inflation target of 2% until, was it 2012?

George Selgin: That's right. January 2012 was when the Fed formally embraced 2%, but it had informally had that as its objective long before. I think the history of that starts in the '80s. Paul Volcker's bringing the inflation rate down from double digits. There are many economists, mostly Keynesians who say, "Look, it's already down to 5%, you can't go any lower. We're going to really have problems in the labor market." Then you have still monetarists holding out for the ideal of literal price stability, which is a zero-

Norbert Michel: Zero.

George Selgin: ... long-run inflation rate. 2%-

Bill Walton: Which is what we had in that century we talked about, the 19th-

George Selgin: Yes.

Bill Walton: ... century.

George Selgin: Absolutely.

Bill Walton: Yeah.

George Selgin: That's right and for some time-

Bill Walton: Mm-hmm (affirmative).

George Selgin: ... afterwards, at least for certain periods-

Bill Walton: Yeah.

George Selgin: ... like the 1920s.

George Selgin: I think partly the 2% outcome was simply a compromise between the Keynesians and the monetarists. It was, "Okay, well, we'll meet halfway and do 2%." That was part of it.

George Selgin: It was also, though, there has been a long-standing argument in economics. It goes way back a century saying, "Well, a little inflation helps to grease the gears of industry and the labor markets, et cetera, so if we have a little inflation, it makes unemployment less serious." It's not quite the belief that more inflation always gives you less unemployment. That belief had been pretty much put paid to by the great stagnation of the late '70s and '80s. But, there developed instead the popular belief that 2% means less frictional unemployment. People can find their job. That also had a big influence on the rise of this 2% ideal.

George Selgin: It is true, it's a remarkable phenomenon, that the Fed managed to just slip into this-

Bill Walton: Mm-hmm (affirmative).

George Selgin: ... as did many other central banks, because 2% became the common ideal among other central banks around the same time. They slipped into that with very little actual public discussion and debate, with very few people saying, "Wait a minute, this isn't-

Norbert Michel: Maybe not-

George Selgin: ... price stability."

Norbert Michel: ... such a great...

George Selgin: "This isn't what the mandate says." They have gotten away with that. Now-

Bill Walton: Well, they-

George Selgin: ... they're pushing for three.

Bill Walton: But, it raises-

Norbert Michel: Yeah.

Bill Walton: ... one of the issues in my opening about the Fed's independence. There are some people that believe that the Fed should be above all politics and all intervention and all agendas from anybody else.

Norbert Michel: Right.

Bill Walton: It should be the omnipotent seven people who decide in their wisdom what to do.

Bill Walton: Then, there are other people that say, "No, it should be politicized to the extent that we all have a say in whether the targets going to be 2% or zero."

Norbert Michel: Mm-hmm (affirmative). I'm on the let's have them accountable side. I want the standards to be there. I want them to be-

Bill Walton: You don't think-

Norbert Michel: ... transparent.

Bill Walton: ... the Fed independence is something-

Norbert Michel: No, I don't. If we're talking about, do I want a president to constantly go in and say, "This is what we need to do," every single day at the Fed.

Bill Walton: But, we have a president like that.

George Selgin: Trying, yeah.

Norbert Michel: Maybe that's not ideal.

Bill Walton: Yeah.

Norbert Michel: I understand that. But, on the other hand, that president can lose the next election that he faces, if people don't like what he's doing. That's better, in my mind, than having somebody at the Fed for 14 years doing whatever they want, and nobody knows what they're doing, or how they're doing it.

Norbert Michel: If you look over the history of this, they have not been politically independent. When you start talking about unemployment and inflation-

Bill Walton: Well, didn't Richard-

Norbert Michel: ... and-

Bill Walton: ... Nixon-

Norbert Michel: ... stability-

Bill Walton: ... and Arthur Burns get together-

Norbert Michel: Arthur Burns.

Bill Walton: ... regularly to talk about-

George Selgin: Yes, they did.

Norbert Michel: Oh, yeah.

George Selgin: Goosing the economy, so he could get re-elected.

Norbert Michel: Yeah, they're on the-

George Selgin: And, Lyndon Johnson physically assaulted the previous Fed chair and-

Bill Walton: Was that Martin that he-

George Selgin: That was-

Norbert Michel: Was it [inaudible 00:35:22]? No.

George Selgin: No.

Bill Walton: Anyway, it doesn't matter, but, yeah.

George Selgin: Why his name escaping me? That's terrible.

Norbert Michel: Arthur Burns and Nixon are on the Nixon tapes making fun of the idea that the Fed is independent.

Bill Walton: Mm-hmm (affirmative).

Norbert Michel: It was a joke. Historically, it is something of a joke, because they have not operated independently.

Norbert Michel: In the 2008 financial crisis, you have the Fed and Treasury working very closely to implement the bailouts and, in their mind, save the financial universe, which is fine. In my mind, again, that's how it should be. It should all be out in the open.

Bill Walton: Well, they are inter-related in their functions.

Norbert Michel: They certainly are, and we should drop the fiction that they're not.

Bill Walton: George, where are you on that?

George Selgin: Well, I don't quite want to drop the fiction, such as it is. I think that it is-

Norbert Michel: We can disagree.

George Selgin: ... desirable, it is desirable for the Fed to, for the government to keep its hands off day-to-day Fed decisions, and I think that it should be an understanding that direct pressure from the government on the Fed to alter its monetary policies, though it's something that is bound to happen, it is not something that the Fed should easily yield to. Because, presidents and administrations have their own short-run concerns, that are often contrary to the needs of a stable economy like getting re-elected. I think the idea of Fed independence, and what little independence it enjoys, is worth trying to preserve.

George Selgin: On the other hand, Congress absolutely has the responsibility both for dictating the mandate that the Fed should follow and for seeing that it actually does follow it. I think it's a mistake for Congress to simply defer to the Fed and say, "Well, if you want to define price stability this way, that way, or the other way, that's fine." Because, at that point, Congress is not doing its job.

Norbert Michel: But, that's what happens.

George Selgin: That is what's happened.

Norbert Michel: That's what happens.

Bill Walton: But, in another [inaudible 00:37:31], its related context, there's a lot of people, Peter Wallison's one of them, that... talked about the administrative state, and about how Congress has really punted to give to the agencies, not the agencies, the-

Norbert Michel: Oh, yeah.

Bill Walton: ... the cabinet departments full authority to do things, so they don't have to take responsibility for it. I guess this is-

Norbert Michel: And, the independent-

Bill Walton: ... analogous.

Norbert Michel: And, the independent agencies.

Bill Walton: Yeah.

Norbert Michel: Definitely.

George Selgin: No, they're-

Norbert Michel: It's analogous.

George Selgin: The Fed enjoys aspects of independence that are undesirable and, sometimes, doesn't enjoy-

Norbert Michel: Right.

George Selgin: ... the kind of independence that is desirable. Ideally, you want the Fed to be accountable, and you don't want the federal government dictating monetary policy.

George Selgin: For one thing, if Congress had control over monetary policy, they would have the Fed pay for whatever.

Bill Walton: Well, that would be called modern monetary theory.

George Selgin: That, exactly, would be called-

Bill Walton: Which I want to-

George Selgin: ... modern monetary theory.

Bill Walton: Let me, tell me about, it sounds dangerous.

George Selgin: I think it is dangerous-

Norbert Michel: [crosstalk 00:38:44]-

George Selgin: ... Bill.

Bill Walton: First, what is it?

George Selgin: Modern monetary theory, if you had to, it is, first of all, it's not a theory. It's a cluster of ideas.

Norbert Michel: And, it's not modern.

George Selgin: Well, some of them are not modern at all. That's right. Many of them are quite old-fashion.

George Selgin: It's a cluster of ideas. It's necessary to say that, because they'll quickly point out, "Oh, but you've left this out. You left that out."

George Selgin: They have ideas about guaranteeing jobs for everyone. They have ideas about the origins of money. They have ideas about how money is created, in fact, in our modern monetary system. They also have normative ideas about what the Fed should or shouldn't do, and what Congress should or shouldn't do.

George Selgin: I think though that the aspect of modern monetary theory, that's got everyone's attention these days, which is one we probably should talk about, is one that says that a nation like the United States, that has its own sovereign currency, fiat currency, never has to worry about not being able to pay its bills, because it can always print all the money necessary. And, it doesn't have to worry about deficits, because it can always fund the deficits.

George Selgin: The danger, what makes all of this dangerous is precisely the fact that in some respects it's true, but it's not true in the respects that most matter. It is literally true that a country can always, with fiat money, can always pay any amount of expenses. It is not true that it can do that without adverse consequences like, potentially, hyperinflation, for example.

George Selgin: Now, here's where these guys get really dangerous. They're tricky. Every time they write about the government's unlimited capacity through monetization to pay all of its expenses, any amount, Green New Deal, you name it-

Bill Walton: Monetization means they just issue more money.

George Selgin: Issue more money to cover the expenses.

Bill Walton: Right.

George Selgin: Whenever they say this, they're always pretty careful to somewhere say in a side note, "Oh, yeah, well, of course, if inflation starts to break out, then we have to take steps to change it." By the way, they believe that Congress should control inflation by regulating taxes-

Norbert Michel: Taxes.

George Selgin: ... and spending to do that, which is itself a real can of worms, for anyone who knows how Congressional decision-making works, but, anyway...

Bill Walton: You're not making me feel optimistic.

George Selgin: I know, so, put that aside. They have, they always make a point of mentioning inflation, but they have 20 paragraphs saying, "We can pay for anything, no problem," and then they have one saying, "Of course, if there's inflation, we'll have to do something." What they've done is to build an immense popularity based on 19 paragraphs that talk about how we can pay for everything by printing money, and they use-

Norbert Michel: Ignore the [crosstalk 00:41:35]-

George Selgin: The last paragraph is still, pay no attention to the paragraph behind the curtain. But, they drag that out, if a critic like Norbert or me says, "This is really dangerous stuff. This could lead to inflation." They say, "Don't you read our theories? You haven't paid any attention. Look at paragraph 20."

Norbert Michel: Mm-hmm (affirmative).

George Selgin: It says, "We have to worry about inflation."

Bill Walton: On page six in 4-point font in the-

George Selgin: Exactly.

Bill Walton: ... footnote.

George Selgin: This is-

Norbert Michel: Something like that.

George Selgin: They're very, very slippery, because they say the things they have to say to evade the obvious criticism, that paying for everything by printing new money can lead to high inflation. But, their popularity rests on not drawing too much attention to that-

Norbert Michel: Right.

George Selgin: ... caveat.

Bill Walton: Well, we've got a few minutes left. I want to take us from where we are to where we want to go. But, before we go completely to where we want to be next, I'm going to finally learn what quantitative easing is.

Norbert Michel: Ah.

Bill Walton: We have been hearing about quantitative easing for years. What is quantitative easing in three sentences or less?

Norbert Michel: Basically, it's the central bank buying large amounts of assets.

Bill Walton: Okay, not Treasury securities, but-

George Selgin: But, they-

Norbert Michel: Well-

George Selgin: ... can be Treasury-

Norbert Michel: ... they could be treasuries.

Bill Walton: They can be treasuries, but-

Norbert Michel: They could be treasuries.

Bill Walton: All right, so their balance sheet's gone from $800 billion to $3.8 trillion right now.

George Selgin: Yes, that's-

Bill Walton: Right?

George Selgin: ... about right, yes.

Norbert Michel: Mm-hmm (affirmative).

George Selgin: It had been higher, and they shrunk it a little bit.

George Selgin: But, there's more to it than that. Of course, central-

Norbert Michel: It was my one-

George Selgin: ... banks-

Norbert Michel: That was my one sentence.

George Selgin: Yeah. He gets one, and-

Bill Walton: We cut you off. Sorry.

Norbert Michel: No, no.

George Selgin: They buy, the central banks have bought assets in the past, of course. But, quantitative easing refers to buying a lot of assets at the same time that either interest rates are at zero, or the Fed is paying enough interest on bank reserves to get the banks to horde any reserves that they create. Quantitative easing is a policy of making up for the fact that banks are just hording as many reserves as come their way, as much cash as comes their way, making up for it, by creating that much more cash.

George Selgin: The idea is, if you're in a situation where small amounts of asset purchases and reserve cash creation don't do anything, because the banks are just clinging to whatever is created-

Norbert Michel: We're not expanding the economy [crosstalk 00:44:09]-

George Selgin: Then, if we do enough of that, then, maybe, it will still do something.

Bill Walton: I still think I'm... Professor Selgin, I might flunk-

Norbert Michel: So, the-

Bill Walton: ... your midterm exam.

George Selgin: Uh-oh.

Norbert Michel: Normally, the central bank would be buying things to get money out into the economy.

Bill Walton: Well, let me-

Norbert Michel: They would be-

Bill Walton: ... let me-

Norbert Michel: ... buying-

Bill Walton: ... let me

Norbert Michel: ... treasuries.

Bill Walton: ... let me break it down. Bank reserves, the way, the good old days, the Federal Reserve would provide some reserves to the commercial banks, and commercial banks would turn around and lend that out. That would be stimulative to the economy, because, presumably, they're going into the hands of borrowers that are going to build things and do things-

George Selgin: That's right.

Norbert Michel: That's right.

Bill Walton: ... and grow businesses.

George Selgin: The reserve creation normally would mean that the cost of funds has fallen, banks see this as an opportunity to make more profitable loans.

Bill Walton: They're not making any money on reserves, because they're paying no interest. But, then, when the Fed says-

Norbert Michel: In that world.

Bill Walton: ... "Look, we're going to pay you 2%," then, the banks say, "Well, look, this is a pretty-

Norbert Michel: It's a great deal.

Bill Walton: ... safe deal. We're going to hold onto it."

George Selgin: That's right.

Bill Walton: They don't go out and stimulate businesses and economic growth.

George Selgin: That's right, not the-

Norbert Michel: That's right.

George Selgin: ... usual way. The Fed could create large amounts of reserves again today. But, given the new setup of interest on reserves, it wouldn't stimulate the economy in the usual way. But, their theory... They had these theories that they developed during the crisis that said, "But, if we do enough of that, maybe it will have some other stimulative effects like getting rid of the risk premium on long-term bonds." That's one of the popular ones.

Bill Walton: You're co-chairman of the Fed right now, and we are where we are. We've got a $3.8 trillion balance sheet. We're paying interest on reserves. We've lost a lot of flexibility about how to manage interest rates, manage money, that sort of thing. What do you do? How do you, where do we go from here?

Norbert Michel: I would go back to normalizing in the sense that everybody took it originally, back in 2008, which is we're going to get back to what we normally do. We're going to, over time, slowly, not dump everything, but, over time, get rid of these assets, get back to a balance sheet that's closer to where we were, stop paying interest on excess reserves. I don't necessarily have a problem paying interest on the reserve itself, but not on excess reserves, and try to get back to an interbank lending market, which is very important, a very important part of the system and a very important part of a financial system, and we don't have that now.

Norbert Michel: That's where I would go. I would go back to that.

Bill Walton: George?

George Selgin: Yeah, I agree with Norbert. We have... For all its size before the crisis, the Fed was lean and mean compared to today, and that system worked reasonably well. It could be improved upon, but I think it's much safer in the long run to have a Fed that operates with a small balance sheet, that's not able to engage in quantitative easing, because that exposes the Fed to demands, all sorts of demands to buy these bonds or those bonds. That's a dangerous situation in my opinion, especially with modern monetary theorists lurking around.

George Selgin: For both strictly economic and political reasons, I think the Fed should make a serious, a more serious effort than it has to truly normalize its operations, so that we can at least have a Fed that's no worse than it was in 2007. That's not asking a lot, and we certainly should try to aim for better still than that.

Norbert Michel: We can shoot higher, but-

George Selgin: But, I think-

Norbert Michel: ... let's start there.

George Selgin: ... the present Fed is a much more dangerous animal than even the Fed of the past.

Norbert Michel: Yeah. With the modern monetary theory crowd, they've, this is a bad time, because what the Fed has done is set up a framework where these MMT guys can say, "Well, look, you guys can buy a whole bunch of assets. We don't have to worry about inflation."

George Selgin: "Hey, you can just raise the interest rate [crosstalk 00:48:18]-

Bill Walton: The Fed's gone from lender of last resort to the Congress' piggy bank.

George Selgin: Exactly.

Norbert Michel: Yes.

George Selgin: Exactly, that is exactly what could-

Norbert Michel: Yes.

George Selgin: ... happen, what could-

Norbert Michel: [crosstalk 00:48:26]-

George Selgin: ... happen.

Norbert Michel: We're right there.

George Selgin: I don't think Fed officials would want to be buying Green New Deal bonds in trillions of dollars-

Bill Walton: I don't think Jay Powell-

George Selgin: ... per year.

Bill Walton: ... wants to do that.

George Selgin: I don't think they-

Norbert Michel: Probably doesn't.

George Selgin: ... want to do that. But, the other-

Norbert Michel: But-

George Selgin: ... point that shouldn't be ignored is that this gets back to the question of independence. Congress has raided the Fed's balance sheet in the past. It took its capital away on two occasions. It's left it with a very slim margin of capital, surplus capital.

George Selgin: If Congress can do that, if they can eye the Fed's balance sheet and say, "Hey, here's a couple, ten trillion dollars worth of capital. Let's take it." Why wouldn't they look at the-

Norbert Michel: They will.

George Selgin: ... Fed and said, "Here's an unlimited capacity for quantitative easing. Let's take that too-

Norbert Michel: Mm-hmm (affirmative).

George Selgin: ... and fund much more."

Norbert Michel: Yeah.

George Selgin: The program isn't really fiscally advantageous, because the banks have to get paid interest on reserves, and it ends up being a costly way of funding government. But, it looks advantageous-

Norbert Michel: It looks like it.

George Selgin: ... to the public, and it bypasses the appropriations process. You can bet there are a lot of Congressmen who will say, "Even if this is bad fiscally, not the cheapest way to fund things, it's the only way we can fund a lot of things we'd like to get through."

Norbert Michel: Mm-hmm (affirmative).

Bill Walton: Once again, we're in Washington, and we're just shocked at the way this works.

George Selgin: Well, I've been in Washington for five years, so I... You have too, Bill.

Bill Walton: Well, I've been here longer.

George Selgin: Yeah, you've been here longer. How can you possibly be shocked anymore?

Bill Walton: I think I'm being facetious. George Selgin, Cato, you can find George on the Cato website. He's written extensively on banking, free banking, prices. A great body of work, and I'm looking forward to having you back to talk some more about this. But, I think, from my point of view, we got about this far. There's a lot further to go.

George Selgin: Yeah, it is a lot.

Bill Walton: Norbert, Heritage Foundation, head of the Center for Data Analysis, extensive writing on Dodd-Frank, on the normalization issues, on the turning banks into utilities, and you've got-

Norbert Michel: Yes.

Bill Walton: ... a lot of interesting work on there. Highly recommend, if you want to follow up on this, to go on the websites and look at those.

Bill Walton: In our case, I hope you enjoyed the show. If you liked it, subscribe to the show on YouTube or iTunes and give us your comments on iTunes, if you like what you're hearing and seeing.

Bill Walton: Thank you, and we'll see you again soon, George-

Norbert Michel: Thanks, Bill.

Bill Walton: ... Norbert.

George Selgin: Thank you, Bill.

Bill Walton: Thanks, guys.

Norbert Michel: Appreciate it.

Bill Walton: Great.

Crew: All right.

Norbert Michel: That's it?

Crew: Excellent. Good job, everybody.

Bill Walton: I think we got through wonk world pretty well.

Crew: Wonk world.

Norbert Michel: It didn't go-

Bill Walton: It's a-

Norbert Michel: It didn't go-

Bill Walton: ... tough subject to make-

Norbert Michel: It didn't go too badly, did it?

Bill Walton: No-

George Selgin: Considering-

Bill Walton: ... I thought it went well.

George Selgin: ... all the items on your list, I didn't think we'd get through more than about-

Norbert Michel: A handful.

George Selgin: ... a third, yeah.

Bill Walton: Well, but the thing is, you can go very deep and get to the ultimate truth of this thing, and we can only get to the highlights, and I think we got the highlights. I think we raised the issues.

Norbert Michel: I think so.

George Selgin: Mm-hmm (affirmative).

Norbert Michel: We're not hooked up.

Crew: Opening worked well, so I think [crosstalk 00:51:40]-

Bill Walton: I think we're done with the opening, yeah.

George Selgin: Just going to use the restroom again, I'm sorry.

Bill Walton: Guys-