Episode 222: "What You Need to Know About Your Money and the Federal Reserve" with Cato's Norbert Michel

Bill Walton (00:00):

I've almost worn my suspenders in your honor, because I was [inaudible 00:00:05] back then. And we're still using it for promotion. I need to... What do you think? Bring the suspenders back from time to time.

Speaker 2 (00:11):

Yeah, [inaudible 00:00:12].

Bill Walton (00:12):

But everybody... I thought I looked like a Wall Street banker and everybody told me I look like Larry King. And I don't want look like Larry King. I wanted to look like a master of the universe.

Norbert Michel (00:21):

Yeah, maybe don't bring them back. I didn't think about the Larry King part.

Speaker 4 (00:31):

Welcome to the Bill Walton Show featuring conversations with leaders, entrepreneurs, artists and thinkers. Fresh perspectives on money, culture, politics and human flourishing. Interesting people, interesting things.

Bill Walton (00:50):

Welcome To the Bill Walton Show. I'm Bill Walton. One of the goals of this show is to try to explain complicated things in ways we can all understand. Well, one of the things that's moved to the top of my list is money. When I started out in commercial banking in the 1970s, it all seemed pretty straightforward. Now, not so much. Here's just some of my questions.

(01:18):

What's a central bank digital currency? Sounds ominous, but is it a good thing? How does the Federal Reserve set interest rates? What's the dollar's world reserve currency status really mean, and does it matter? Can the Fed really do anything to stop inflation or does the Fed really think that its mission now is to fight global climate change or to promote social justice? Do we even need the Fed? For some answers I'm joined again by one of my favorite guests and good friend Norbert Michel, who's vice president and director of Cato Institute's Center for Monetary and Financial Alternatives. Norbert has the high distinction of being a guest on my second episode almost six years ago. And we had a great time with Jack Spencer. You guys were at Heritage then?

Norbert Michel (02:15):

Yeah.

Bill Walton (02:17):

And actually you were on with George Selgin about two and a half, three years ago.

Norbert Michel (02:21):

That's right. That's right.

Bill Walton (02:21):

Talking about money.

Norbert Michel (02:22):

This is my third shot.

Bill Walton (02:24):

And third time is really the charm. Because the list of questions I've got is crazy complicated.

Norbert Michel (02:32):

It keeps getting more complicated, I think. Yeah.

Bill Walton (02:34):

It is. So that's your take too. It is getting more complicated.

Norbert Michel (02:37):

I would agree with that. Yeah.

Bill Walton (02:39):

So where do you want to start with my list? Do you want to try interest rates?

Norbert Michel (02:42):

I love the interest rate one. Yes.

Bill Walton (02:43):

Okay, let's go with that.

Norbert Michel (02:45):

So everybody always says that the Fed sets interest rates or that the Fed has kept interest rates too low for too long or some version of that. And I understand why. They do set an interest rate target, but the truth of the matter is they can't just make interest rates whatever they want. So we don't want to give them too much credit or too much blame. What they do certainly affects credit markets, but they do not simply set interest rates. They do administratively set a policy rate now, and that's the interest rate that they pay on reserves and as well as the discount window rate and that sort of thing.

(03:34):

But the Fed funds rate means nothing anymore really. It's sort of a nominal thing. And when we look out over the broader financial markets, the truth of the matter is what they do does not set those rates. And they are trying to have an effect on the supply of credit or the demand for credit by trying to affect the price, but they simply don't set rates. So why that's important is, you'll hear many people critique the Fed for... Just for example, prior to the 2008 crisis, somewhere back in the early 2000s, keeping interest rates too low for too long. Or there's zero interest rate policy. Keeping interest rates near zero forever.

Bill Walton (04:26):

I've said that.

Norbert Michel (04:27):

And many people will.

Bill Walton (04:30):

Correct.

Norbert Michel (04:30):

And many people will. But if you look at what they do, and if you look at the way that rates move, they tend to follow rate movements. In other words, they adjust their targets based on what's happening in the market. And they try, and historically, historically, they have tried to keep a minimal footprint in the markets. Now that footprint has grown, but not because of their strict monetary policy piece.

(04:57):

It's because of the emergency lending and the sort of these extra monetary policy type of things that they do now, that they didn't do before. There's a reverse repo facility for the money market funds. There's $2 trillion of cash sitting there. The Fed is supposed to be the lender of last resort. That's not lending, that's the Fed effectively borrowing money. So they're taking cash out of the economy for that. So that's not a rate setting policy and that's not a credit setting policy and it's certainly not monetary policy.

Bill Walton (05:32):

Well, does Cato have a position about what the Fed should be doing or not doing? And let me back up. Let's do a little history. This is part of the series, I think of three shows so far I've done on money. And Federal Reserve created when? 1912, 1914? Roughly?

Norbert Michel (05:54):

1912, 1913. Yeah, somewhere [inaudible 00:05:54].

Bill Walton (05:54):

And it was a lot of opposition to it. And it was part of the progressive legislation in the early nineteen-teens or something like that. And so it was set up actually by a bunch of New York banks who thought they could control the system.

Norbert Michel (06:14):

Yes, that's right.

Bill Walton (06:15):

So fast forward to today, that's over a 100 years ago. The Fed's powers have grown. The number of banks have shrunk, and it's now finding itself in a more privileged position than ever.

Norbert Michel (06:27):

Yes, no doubt. You have the system that was created for one particular thing under the gold standard. Under a completely different monetary system than what we have now. The idea was effectively to have these reserve associations, these sort of clearing houses modeled after what was going on in the private sector. And it was very much a New York bank, large bank driven move to get something that was more stable or solid for them.

(07:00):

And look, reserves don't mean the same thing now as they did under the gold standard. This is a completely different world, and it's gotten completely different consistently through time. You have a pure fiat system now. And we have, I would argue a more important public-private arrangement now. Or I'm sorry, a more definitive public-private arrangement. So you have this weird sort of public piece of this. It's the US dollar, but you still have private markets, banks, creating deposits. So when we say things like, the Fed creates all this money. That's not quite right. Does the Fed enable a certain amount of creation of money? Yes. But it's not them by themselves.

Bill Walton (07:52):

So why do we spend all our time and ink on the Fed?

Norbert Michel (07:57):

That is a great question. We parse the language of the things that they say. We look at Federal Open Market Committee statements and...

Bill Walton (08:06):

Well, if you're trading bonds up in New York on Wall Street, you got to pay attention because you're interested in market signals and things like that. But what you're saying is in terms of the macro economy, it doesn't really matter that much.

Norbert Michel (08:17):

That's right. No, that's exactly what I'm saying. Yeah. It's one thing to be a Wall Street trader and worry about getting the 10th of a percentage point return on something. But the idea that what the Fed is doing is sitting down in a basement and turning some dials and cranking up unemployment or cranking down inflation or cranking up GDP, it's just not true. It just doesn't work that way. And the '08 crisis is a great example. If the Fed could control things, that would've never happened.

(08:48):

The current crisis, or if you want to call it the COVID fallout with all the supply chain stuff and everything...

Bill Walton (08:57):

That was a crisis.

Norbert Michel (08:57):

Oh, yeah. Okay. So I mean, another great example though, right? If the Fed could just turn some dials and make that stuff go away, don't you think they would? They would.

Bill Walton (09:05):

Isn't the Fed sort of a funny structure though, because we talked about the Fed. You've got the Fed in DC and then you've got the Federal Open Market Committee. And then you've got the 12 regional banks. And Jay Powell and the chairman and the Fed in DC has become a more prominent spokesman for all this, but it's really a much more complicated system.

Norbert Michel (09:34):

Oh, yeah. And it's an outdated system. That was part of the deal that they put it together that way in the early 1900s. It was part of the deal to get [inaudible 00:09:43].

Bill Walton (09:43):

Nobody wanted a central bank. And so they said, "Okay, Kansas City, you can have your own bank. Richmond, you can have a bank. Atlanta, you can have a bank." So everybody got their own federal reserve bank.

Norbert Michel (09:54):

Yeah, those different associations. Those sort of clearing [inaudible 00:09:58] all over.

Bill Walton (09:58):

Now, when I was a commercial banker in Chicago, I was at Continental Illinois Bank. And it was really very funny because on LaSalle Street, the foot of LaSalle Street, you had the CBO, the Board of Trade, trading all the agricultural commodities. And then the Federal Reserve was on one side of LaSalle Street with all the columns. And just on the opposite side of LaSalle Street was Continental Bank. And they looked exactly alike.

Norbert Michel (10:25):

All the same.

Bill Walton (10:26):

Except the Federal Reserve Bank had Corinthian columns. And the Continental Bank had to have Doric columns because they didn't want people confused. As if people knew the difference between Corinthian and Doric.

Norbert Michel (10:38):

No, I'd have to look that one up too.

Bill Walton (10:40):

So in those days you wanted to look, you wanted to be marble, you wanted to have Greek columns. You wanted to be solid.

Norbert Michel (10:45):

Inspire confidence.

Bill Walton (10:46):

So that was Chicago's bank. I digress, but I thought it was interesting.

Norbert Michel (10:52):

It is. No, but it's a good point because we're very quick to say, the Fed does this, or the Fed does that. And it's a really weird structure. It is outdated. It no longer serves the purpose that it was originally created to serve. So those district banks really don't make any sense at all, if you look at what was they were supposed to be when they started the system. We just don't do that anymore.

Bill Walton (11:21):

Continental Bank has been turned into a shopping mall. I'm not sure about what's happened to the Fed across the street, but anyway.

Norbert Michel (11:26):

I know they're still there. And the board in the 1930s, the board in DC gained essentially complete control over the system. It's only gotten worse, but-

Bill Walton (11:40):

The board in DC.

Norbert Michel (11:41):

The board in DC.

Bill Walton (11:42):

Federal Reserve board. They control the system as of the '30s.

Norbert Michel (11:45):

Yes.

Bill Walton (11:46):

Okay.

Norbert Michel (11:48):

At least by virtue of a majority rule.

Bill Walton (11:51):

Sure.

Norbert Michel (11:51):

Yes. And it's only gotten worse little bit by little bit over time. So it's really not the case that the Fed is a private bank. Yes, those district banks are not federal agencies. But it doesn't really matter. Because the Federal Reserve Board is a federal agency and the Federal Reserve Board is running the shop. So what you have, when you say, the Fed, is you have this oversight board, if you will, in DC. And you have these district banks all around the country. And they've become sort of these research and advocacy groups. There's all kinds of economists. Thousands and thousands of economists doing research. And the board has their own as well. And they're feeding policy...

Bill Walton (12:39):

Well, they have a 1000 economists. They all went to MIT. They all learn the same models. They have exactly the same worldview. And they all wear those little propeller beanies. Or do they? [inaudible 00:12:53] issue at the Fed.

Norbert Michel (12:53):

That might be right. I'm not sure. I haven't seen the propellers, so I can't say.

Bill Walton (12:59):

One of my professors at George Washington, when I took a couple classes there was a Fed economist. He was the one that made the joke.

Norbert Michel (13:07):

Did he? Okay. I was going to say, did he come in with the beanie because-

Bill Walton (13:08):

He didn't have one. He didn't have one.

Norbert Michel (13:08):

All right.

Bill Walton (13:10):

But he thought everybody else did. Well, you say something, you mentioned setting policies and writing papers. The 12 banks, you take a look at the San Francisco Fed, the San Francisco Fed has become notoriously woke. And they were the ones that oversaw the Silicon Valley debacle.

Norbert Michel (13:29):

That's right.

Bill Walton (13:29):

And if you go on the Federal Reserve website, I haven't done it quite recently, it's just filled with papers about how Fed monetary policy ought to be bringing about social justice. And Fed monetary policy ought to be fighting global climate change. And my view is the Fed can't really even do its own principle mission very well, which is maintaining a strong currency. So it's got all these mission drifts throughout the system.

Norbert Michel (13:57):

Oh, yeah. No, we agree there completely. Their main sort of mandate on macro policy, I would say is also outdated. It's not something that we [inaudible 00:14:13].

Bill Walton (14:12):

The Fed is supposed to... The dual mandate is what? It's supposed to be stable money.

Norbert Michel (14:18):

Stable prices.

Bill Walton (14:19):

Second mandate is full employment.

Norbert Michel (14:21):

Stable prices, maximum employment. And then there's actually a moderate interest rate one in there too. So it's technically three, but nobody talks about that one. Even though they say the Fed sets interest rates.

Bill Walton (14:31):

Well, I never even knew based on what we're talking about how the Fed can possibly maintain a full employment economy.

Norbert Michel (14:36):

They can't. They can't.

Bill Walton (14:38):

So it's got one sitting right there that somebody, politician, thought was a good idea, but it can't even do it.

Norbert Michel (14:43):

That's right. No, that's right. And this came out of the '60s and '70s with the Phillips Curve stuff.

Bill Walton (14:48):

Phillips Curve was a trade off between interest rates and employment.

Norbert Michel (14:51):

That's right.

Bill Walton (14:51):

Yeah. Okay.

Norbert Michel (14:51):

Interest rates, unemployment, trade off. And basically right around the time the economics profession was realizing, "Oh, wait. Maybe that's not an exploitable trade off." Congress wrote it into law. And it's been stuck there.

Bill Walton (15:10):

That's what Congress does, right? Write those really bad ideas in the law. This is Bill Walton Show, and I'm here with Norbert Michel, great friend. Runs the whole money operation at Cato Institute, which is one of my favorite think tanks. And we spent the last 10, 15 minutes or so trying to figure out what the Fed really does. And we're still working on it.

Norbert Michel (15:34):

We might need more than 10 more minutes. But they do. Do you want me to go a little further?

Bill Walton (15:42):

I want you to do whatever... Let's see if we can understand what this is really all about.

Norbert Michel (15:48):

So one thing that the Fed can do is clamp down on credit. They can make credit much tighter and much more difficult to get. And that's something that is possible. They have control over reserve requirements. They have control over discount window lending. They have control over bank funding. There is no doubt that if the Fed wanted to just wreck the economy, they could increase reserve requirements, increase policy rates, and make it incredibly difficult for banks and other financial firms to get funds.

(16:30):

That is possible. But the consequences that would come with that would not be good. So they don't want to be in that position. It's against their interest to do that. And what you'll notice over at least the last, I would argue 50 years, is that what they're trying to do is have an effect on expectations. Have an effect on credit markets, but a minimal effect. So in other words, they don't want credit to go crazy. They don't want money creation to go crazy. They want to hold things in check. But they don't want to clamp down on them so much so that they completely wreck the economy. And you'll see some of this going on right now with [inaudible 00:17:16].

Bill Walton (17:15):

Why aren't they trying to wreck the economy right now? I mean, that was one of my questions. Can the Fed really do anything to stop inflation?

Norbert Michel (17:23):

The biggest thing that they can do is credibly show that they are concerned with inflation and that they are going to get back to their 2% target. And they can do that by adjusting their policy rate, but they only have so much latitude to adjust their policy rate. They can't just say, "We're going to make interest rates 10%." That's not going to work. You actually end up with a lower equilibrium rate if you do that.

Bill Walton (17:51):

Well, they are also trying to manage the stock market. They've got one eye on the stock market as they're doing this.

Norbert Michel (17:57):

And then we talked a little bit about their dual mandate, and we didn't really talk about their financial stability mandate. And I've argued for years now, that that's a bad idea. So this is another part of it, and this is why they have their eye on the stock market and on other parts of the financial sector.

Bill Walton (18:13):

They don't want to cause a stock market crash.

Norbert Michel (18:15):

Yes. They don't want anything messy on their hands. And this is now... So what I'm saying is, look, they can't even control interest rates. They can't control the macro economy. They sure as heck can't control financial markets and stock prices. So what we should not have is a mandate in place that effectively forces them to worry about those things. It's counterproductive.

Bill Walton (18:44):

Well, you had lunch with Jay Powell last week. Did he admit all this?

Norbert Michel (18:48):

I can't talk about that, Bill.

Bill Walton (18:50):

No, but it's pretty good. I mean, just a couple of you having lunch. He's a good guy.

Norbert Michel (18:57):

He is. He is.

Bill Walton (18:57):

I do think he's sitting on top something that's very hard to control.

Norbert Michel (19:00):

I agree. And I can't speak for him, so you'll have to get him on the show and ask him. But I do agree with that.

Bill Walton (19:08):

Do you know the problem of a show like this with elected officials or with people who are in administrative jobs? They'll never tell you anything.

Norbert Michel (19:15):

Not going to be a very big discussion. Very broad discussion. Maybe when he steps down.

Bill Walton (19:20):

He could be very interesting. Yeah. But we're drifting just a bit. But let's explain financial stability. So you're Jay Powell, you're sitting there, you think about financial stability. So you're not worried just about interest rates and credit. You're worried about the stock market, the commodities market. What else?

Norbert Michel (19:39):

And bank failures.

Bill Walton (19:40):

And bank failures.

Norbert Michel (19:41):

Which is what we saw with the Silicon Valley stuff.

Bill Walton (19:43):

So was the Silicon Valley the failure of the Federal Reserve in San Francisco to oversee it properly? Or was it something else?

Norbert Michel (19:51):

Oh, it's a lot. I mean, I think you definitely have... And we don't know all the details yet. So I'll preface what I'm going to say with that. But it certainly looks like there were regulatory supervision failures. At the very least there were some red flags that went up in 2021, in 2022, about the way the bank was hedging its portfolio or not hedging its portfolio. And it seems like an elementary mistake. It seems like one that was actually flagged by the regulators and nothing was done about it. So we have to get to the bottom of that. That does look like that was a failure on the district bank, who is the regulator for that.

Bill Walton (20:34):

Well, you have to be more careful than I do because you've got to talk with all these people. But my understanding was the Federal Reserve of San Francisco had just given Silicon Valley Bank the highest marks for its equity program and its climate program. And that they were just saying the bank is doing a great job, pushing those agendas. And that's not a business I think the Federal Reserve should be in or a bank should be in particularly. But that's my... That's just one-

Norbert Michel (21:05):

I share your take in that that's not something they should be doing. And maybe it is the case that they were wasting too much time doing those things rather than the actual supervision of the bank and the bank's risk. And like I said, it does look like there was a literal failure on the risk management side, supervisory wise.

Bill Walton (21:28):

But the financial problem was they bought long-term bonds at a low interest rate. Interest rates went up and it looks like they were pushed up by the Fed, although we can...

Norbert Michel (21:40):

Right.

Bill Walton (21:41):

So anyway, interest rates-

Norbert Michel (21:42):

I want to come to that but go ahead.

Bill Walton (21:43):

Okay. So the value of their bond portfolio dropped because if you had to sell it, you'd have to sell it for a lot less so people could get that higher yield that was out in the market. Silicon Valley had that problem. But then so did First Republic. And so did... What was the third one that was...

Norbert Michel (22:00):

Signature.

Bill Walton (22:01):

Signature. So is there [inaudible 00:22:06] system, and I've also heard there's like $600 billion of loss in the banking system from that same phenomena. Do we need to worry about the other shoes to start dropping?

Norbert Michel (22:15):

I mean, that's really hard for somebody like you or I to say for sure. I know Gruenberg said something about that.

Bill Walton (22:22):

Gruenberg is who?

Norbert Michel (22:22):

FDIC chair.

Bill Walton (22:23):

Okay.

Norbert Michel (22:24):

And I bet he'd like to walk it back. I don't know. But if you look at unrealized losses without the hedging, yeah, there's certainly a whole bunch of people holding long-term bonds. Now, if it's hedged properly, it's not as big of a concern. And if you don't have runs and you don't have to sell at a loss, it's not as big of a concern. Because if you hold those assets, you're not going to lose the principle. So now that's another question though. Why are they all holding that? Well, that's a regulatory problem.

Bill Walton (22:58):

I think they were encouraged to hold those bonds.

Norbert Michel (23:00):

No. No, thinking. Yes, they were. Most banks look like that now. Because [inaudible 00:23:06] regulation.

Bill Walton (23:06):

So does the Federal Reserve.

Norbert Michel (23:07):

Oh, yeah, yeah. Most banks look like that.

Bill Walton (23:09):

So let's do another question. I don't know if it was on my list. But here's what's happened. We've had... I said, can the Fed stop inflation? I think part of the root cause of inflation is not the Fed, but the massive federal spending.

Norbert Michel (23:23):

Yes.

Bill Walton (23:24):

The 6 or 7 trillion dollars. And the way they paid for that was not through raising taxes or because they had money on hand. They borrowed money.

Norbert Michel (23:33):

That's right.

Bill Walton (23:33):

Treasury issued bonds. The Fed bought those bonds, about half of them. And commercial banks bought the other half, and the commercial banks bought them at the urging of the Federal Reserve. Is that a... I'm not day-to-day on this, but that's my impression about what happened.

Norbert Michel (23:52):

I mean, even without a direct urging, there's every regulatory reason to hold those safe, quote, unquote, "safe assets." The whole system is geared toward holding more of those safe assets. And you also had regulatory requirements requiring more safe assets. So even without a directive from the Fed itself, you have these regulations that require that. And then I think, but this is... You hit it on the head. The core of this, at the beginning of the COVID crisis, you have all this federal spending, all this federal borrowing and spending. The Fed accommodates it. But keep in mind, the Fed is set up partly to do exactly that. I mean, they are fiscal agent of the US Government. They are there to help accommodate more treasury debt. So yes, they bought a third of the debt.

Bill Walton (24:45):

But the Fed is not funded by the feds. The Fed is not funded by Congress. The Fed supports itself with its earnings.

Norbert Michel (24:52):

Correct.

Bill Walton (24:53):

And of course, they're losing money now because of these bond purchases.

Norbert Michel (24:56):

Yes, they are. And because of their operating framework that pays interest on reserves.

Bill Walton (25:01):

To banks.

Norbert Michel (25:03):

To banks, yes.

Bill Walton (25:05):

And so they hold reserves at the Fed instead of lending money to companies to promote the private economy.

Norbert Michel (25:10):

That is right. That is right.

Bill Walton (25:11):

This sounds really screwed up.

Norbert Michel (25:12):

This is the big part. It is. And this is all a continuation of what we did in the '08 crisis. So you see this expansion in '08. And it really is, at the heart of it, it's really just the same idea that, look, no matter what happens, the Federal Government can borrow a bunch of money and spread it around and everything's going to be fine. Well, if you do a little bit of that one time, you might get away with it. But the more of that you do, the more of the risk that you have that it's not going to work.

(25:41):

And you saw some of that after '08 in a slower growing economy, and we've never gotten away from that. We've just kept going. And then instead of clearing it up, we were still in the middle of that mess when the 2020 COVID stuff hits. So then we go even bigger. And sure enough, you've got government directives literally shutting down the economy while you're borrowing and spending all this money. So you're driving demand, you're killing supply. And it becomes a complete disaster. Yes, inflation goes up. Well, when inflation goes up, what happens to interest rates? They go up. People expect prices to go up. So anybody who's doing anything in the financial markets...

Bill Walton (26:25):

You're lending money, you got to get a higher rate.

Norbert Michel (26:27):

That's right?

Bill Walton (26:27):

Yeah.

Norbert Michel (26:28):

So rates go up. And you can see it. Rates went up.

Bill Walton (26:32):

Yeah. Mortgage rates have more than doubled.

Norbert Michel (26:34):

Yeah. And rates started going up before the Fed started raising its targets. And that's an expectation and economic effect that they don't have control over.

Bill Walton (26:43):

This is the Bill Walton Show. I'm here with my friend, Norbert Michel with Cato Institute. And I set out this episode saying we're going to take complicated things and try to understand them in ways we can all understand. And I think where I'm going with this is I'm getting more... It's getting very complicated, but I do think we got it. We have to keep pressing forward because if we just ignore what we think is complicated, it can really end up hurting us. And I want to talk about central bank digital currencies, which I think is one of the things that can really hurt us. But before that, we touched on something that I think is called Modern Monetary Theory.

Norbert Michel (27:28):

Yes.

Bill Walton (27:29):

Which I think is the label for what you just described. Let's talk. What is that?

Norbert Michel (27:34):

It can be, but it doesn't have to be. So you can have all this borrowing and spending without doing the Modern Monetary Theory version. But the MMT version would say that yeah, you need to do a lot of that. You need to do a lot of borrowing and spending, spreading money around to get whatever economic outcome we want. And if there's inflation, you need to increase taxes to counteract that inflation. And you can just sort of steadily manage the economy and make up for any other private shortcomings or the shortcomings in the private economy with government spending. And it's sort of... I mean, there's some technical issues here. But it really is sort of just the basic post-war Keynesian idea writ large.

Bill Walton (28:21):

The government can do anything.

Norbert Michel (28:23):

Yeah.

Bill Walton (28:23):

But I want to get CBDC, but it also leads us to the dollar's status as the world reserve currency. We enjoy an enormous gift because that's the case. We can run massive trade deficits and we can run massive federal budget deficits and really don't have to pay the price as long as everybody's forced to hold dollars.

Norbert Michel (28:46):

Yeah. And they want to hold dollars. So we do. We do sort of have this curse. We can borrow like crazy right now because as messed up as our system might be, and as much as you and I might not like it compared to a lot of other countries, the dollar is really good. Our property rights, our wealth, it's really high. So people want dollars. Our government, as much as we might not like some of the things that they do, much better set of [inaudible 00:29:18].

Bill Walton (29:18):

Well, essentially we're in sync on the idea that people are now... Tucker Carlson did a show recently about what Biden is doing is really jeopardizing the dollar's status as the world reserve currency by politicizing it. And I think he's doing that. But I think the thing, and you're touching on it, the US economy is still about a quarter of the global economy. And then another quarter of the global economy is China. Well, who on Earth wants to hold Chinese currency when you've got it controlled by the Chinese Communist Party? So technically there should be another currency that's rivaling the dollar, but because it's China, it's never going to happen.

Norbert Michel (30:01):

It's not. Certainly not at the moment. I mean, I hate to say never, but yeah. Certainly in the near future.

Bill Walton (30:07):

So the dollar is about 58% of the world reserve currency right now, and it's fluctuated from 90% to 40%. And somewhere in there. The euro is only about 20%. And the euro had a chance to become more dominant, but then they blew it with their banking crisis. And so you're really left with no place else to go. I mean, the UK is about 5%, Japan is about 5%. Japan is a demographic catastrophe. So you look around the world, there are a lot of places you don't want to put your cash.

Norbert Michel (30:41):

Right. Russia? Like, no. You probably don't want to do that.

Bill Walton (30:44):

So what we're saying is we're doing a terrible job, but everybody else is doing worse.

Norbert Michel (30:50):

Worse. Yeah.

Bill Walton (30:51):

So you're not as worried about the global reserve currency status for...

Norbert Michel (30:54):

I'm not. I'm not.

Bill Walton (30:55):

Yeah, neither am I.

Norbert Michel (30:56):

No, I'm not. I think that it's an artifact of how good we are relative to everybody else. And then that's really it. And I would make the argument that we want to be careful and we want to do things to preserve how good we are, but I would want us to do better. But making that the principle driver of our policy is probably not a good idea because it does come with a downside. A self-defeating downside.

Bill Walton (31:27):

So let's talk about what we are concerned about, which is a central bank digital currency. You just published a paper a few days ago. The title of it is?

Norbert Michel (31:38):

Oh, man. [inaudible 00:31:40]

Bill Walton (31:40):

Somebody else gave it the title, but anyway.

Norbert Michel (31:41):

Yeah, I don't know if that one was the, Risks of a CBDC or something along that.

Bill Walton (31:46):

Anyway, it was a comprehensive view about it. It's on the Cato website.

Norbert Michel (31:51):

Yes. My colleague Nick Anthony and I wrote it. And it is a comprehensive look at both the supposed benefits and risks of central bank digital currency.

Bill Walton (32:01):

What are they?

Norbert Michel (32:02):

And do you want me to do both benefits and risks?

Bill Walton (32:05):

Sure.

Norbert Michel (32:06):

Okay. So what you hear from the central bankers or the government officials that want to do this is that it's going to do things like improve financial inclusion, improve payment speed, improve any money laundering capabilities, improve monetary policy. Those are off the top of my head.

Bill Walton (32:27):

We have a cartoon I want to put up on graphics. So Kenny, when we get to this, there's a cartoon which explains the benefits and it's just this narrow tunnel vision of convenience. Anyway, continue. So we'll use this as a graphic.

Norbert Michel (32:43):

Okay. No. And so there's this laundry list of these kinds of benefits. And what they don't really tell you is that if you want those benefits, you have to do all kinds of other things. And you have to do all these things at once or you don't get those benefits. And that's where the risks come in. And the risks are that you will have the central government completely in control of your money. And when I say completely in control, I mean completely.

Bill Walton (33:15):

So it's pretty simple. There are all sorts of variations on it. But in essence, you're no longer checking with the local bank or city group. You're checking with the Federal Reserve. Your checking account is with the Federal Reserve.

Norbert Michel (33:30):

That's right. That's right. And they might tell you that, "Well, we'll just set up a bank so that there's an intermediary in front of it. You just deal with Citibank, don't worry about it."

Bill Walton (33:39):

It's like college rush. They put up the facade, but behind it is the real story.

Norbert Michel (33:44):

Yeah. So imagine your cash, right? Our paper dollars. Technically those are liabilities of the Federal Reserve, but that really doesn't mean all that much because they don't have to do anything. If you have the dollar, you have the dollar. It's kind of like an IOU nothing. The only thing that the Fed is responsible for with that is printing more of them if we need them in circulation. But with a central bank digital currency, it is a digital version of that that is a liability of the Fed. And now it means something. Because now it's on the Fed's balance sheet. It's not on a bank's balance sheet. And now the Fed has to provide an electronic mechanism for you or I to use that dollar.

Bill Walton (34:33):

Really?

Norbert Michel (34:34):

Yes.

Bill Walton (34:35):

So they approve... They've got a document of every transaction.

Norbert Michel (34:41):

Yes.

Bill Walton (34:43):

They fully control every penny really. So they can say, "We don't want you spending money on..." Let's say guns.

Norbert Michel (34:51):

Guns, cigarettes, alcohol.

Bill Walton (34:53):

Diesel fuel, any of the non-woke activities.

Norbert Michel (34:57):

Anything really. Anything. And so when they say things like, "It's going to help us improve monetary policy." What does that mean? Well, that means the Fed can look out and say, "Well, we think spending is too high. We need to have less spending in the economy." Well, how do you have less spending in the economy.

Bill Walton (35:12):

Oh, you're kidding. So they could block access to our money.

Norbert Michel (35:14):

They stop people from spending money. Yeah.

Bill Walton (35:16):

So you thought you had a $1000. But we're only going to let you spend $800.

Norbert Michel (35:19):

Exactly. Yeah, no.

Bill Walton (35:21):

This is tyranny.

Norbert Michel (35:23):

Oh, yeah. This is not some kind of like 1984 or conspiracy theory stuff. I mean, this is real. This is exactly what these guys talk about. We have another product, digital product on the website at Cato, where we talk, where we have quotes, direct quotes from federal and from... I'm sorry, international government officials talking about how great it is going to be to control what everybody does with their money. So this is real. This is coming.

Bill Walton (35:48):

This is real. And Lael Brainard was the woman at the Fed, she's now moved onto the White House. Isn't she next in line to be treasury secretary?

Norbert Michel (35:59):

Well, I mean, she's talked about it in that regard.

Bill Walton (36:03):

Okay, well maybe, maybe not.

Norbert Michel (36:03):

She's an acolyte [inaudible 00:36:05].

Bill Walton (36:05):

So there are a advocates in the White House right now pushing this.

Norbert Michel (36:09):

Oh, yeah. No doubt. No doubt. And this is an interesting thing. I keep hitting your mic. This is an interesting thing when we talk about the Fed. There are people in the Fed who don't want a central bank digital currency. And quite frankly, I think Jay Powell is one. And this isn't about our lunch. I just think from-

Bill Walton (36:28):

Your lunch was completely off the record.

Norbert Michel (36:30):

Completely off the record.

Bill Walton (36:30):

Nothing you're saying has anything to do with that lunch.

Norbert Michel (36:33):

No, nothing to do with that lunch.

Bill Walton (36:34):

All right.

Norbert Michel (36:34):

Public statements only. I think he wants nothing to do with a CBDC.

Bill Walton (36:39):

But Janet Yellen does.

Norbert Michel (36:40):

She does. And Lael Brainard did. So I don't know who is left at the Fed in DC, on the board. Who wants it. Maybe some people in some of the district banks want it, but...

Bill Walton (36:52):

Personally the last person on the planet I want in charge of my money is Janet Yellen.

Norbert Michel (36:54):

Yeah, no, it would not be good.

Bill Walton (36:58):

So they can freeze your funds. Now it also links into the Chinese social credit system.

Norbert Michel (37:04):

Yeah. Well, so they have a central bank digital currency, and that's what they do with it. So they're experimenting with looking at what you're spending on. And if you have good social credit score, you get to spend some more. If you have a bad social credit score, you get to spend some less. So it's programmable in that manner. And this isn't something that you would want a free society to emulate. This is something you would want a free society to run away from.

Bill Walton (37:32):

Well, let's do a working example from today's headline, January 6th. Anybody involved in January 6th, if we had CBDC, they would've all their bank accounts cut off.

Norbert Michel (37:44):

More than likely, yes. Yes. And you saw this happen in Canada.

Bill Walton (37:47):

Yeah, when the truckers were...

Norbert Michel (37:48):

The trucker protest [inaudible 00:37:49].

Bill Walton (37:49):

What were they? The vaccine... Whatever.

Norbert Michel (37:52):

They were protesting COVID shutdowns [inaudible 00:37:54] mandates, yeah. So we could already have that happen. As Canada shows, you don't need the central bank digital currency to do that. But the central bank digital currency makes it a lot easier. And for the central bank digital currency to truly work, you have to take other options away from people. So they'll say, "Well, no, no. We don't want to take away your cash. We just want to have this other option." Well, if I have cash as another option, then I don't care what you do with your CBDC. Right? But the only way that that works from the policy perspective is to make sure that you don't have any other options. Because that's the only way that you can force people to behave a certain way.

Bill Walton (38:34):

Well, let's let talk about other options, because the thing that's happened in the last 20, 30, 40 years are non-bank financial intermediaries. Both on the internet and with storefronts. And then we also have cryptocurrencies. And so those are out there. How do those two pieces interact with this?

Norbert Michel (39:01):

Well, those two things together, and I'd say the non-bank probably to a greater degree have had an effect on what the Fed can and can't control.

Bill Walton (39:12):

Because you mentioned Fed controls credit. I don't think so as much-

Norbert Michel (39:15):

Not to the degree they used to. That's correct. No, that's right.

Bill Walton (39:18):

Because there's a lot of non-bank financial credit providers. I ran one of them.

Norbert Michel (39:22):

That's right.

Bill Walton (39:22):

And so you don't need to go to your bank for risk capital. You can go to one of them. And they're like, what? Half of the market now?

Norbert Michel (39:30):

Yes. It's gone further that way. Yeah. That's right.

Bill Walton (39:32):

So when we talk about banking, there's a big chunk of the market that's not banks.

Norbert Michel (39:38):

That's right. That's right. And now you also see these new alternatives, crypto coming up. That hasn't taken off yet to a degree that-

Bill Walton (39:46):

Well, nobody understands them.

Norbert Michel (39:47):

Right. But, it's early. And I think the way that we say...

Bill Walton (39:54):

Sam Bankman-Fried understood them.

Norbert Michel (39:55):

Yeah. He really messed us up on that.

Bill Walton (39:57):

He did.

Norbert Michel (39:59):

You just can't trust some people. But the way that we should look at this is that we should have more private alternatives, and we should have a regulatory and legal framework that makes it easier and makes it easy for people to use those alternatives for money as they see fit. So whether it's crypto or gold or whatever. Whatever people want to use. They should be able to do that.

Bill Walton (40:28):

We talk about fiat currency, as I've said, there's a long list of complicated... Fiat currency is basically money that's not backed by anything.

Norbert Michel (40:36):

That's right.

Bill Walton (40:39):

And a friend of mine who's a gold bug gave me this terrific book, and it's compilation of all the failed fiat currencies over the last 4,000 years going back to Egypt and China and India and all that. And governments are always trying to get you to take paper that has no backing. And they've all failed. And we're looking at a fiat system right now, not only the US but worldwide.

Norbert Michel (41:10):

Pretty much everywhere.

Bill Walton (41:11):

Should we be nervous?

Norbert Michel (41:12):

I wouldn't be nervous simply because of that. And the reason that... And this is where I get in trouble with the gold bugs. Because as appealing as that system sounds, and as good as it did for a while, it too failed. And to have it work internationally you would need governments to cooperate. And at this point, you would need people to understand gold and recognize gold as money. So I don't think that's something that we should shoot for, but I do think that we should just let people decide. I think people should have alternatives. Whether it's a crypto, whether it's a stablecoin, whether it's some kind of gold backed credit card or whatever it is, I think that that's the thing that we don't have now, and that's the thing that we need.

Bill Walton (42:02):

So that's a Cato recommendation.

Norbert Michel (42:05):

Yes. And I actually made that recommendation even when I was still at Heritage and in another lifetime.

Bill Walton (42:09):

Well, that counts.

Norbert Michel (42:10):

So yeah. So I'm consistent on this. I think this is the way to go. I think you do have a public-private relationship with money already, and people don't think of it this way, but when you go to a bank and you make a loan that is private money creation. What we would allow people to do is create whatever kind of money they want when they do that. And you don't have the legal and economic incentives yet to do that. There are some that are there, but there are some very clear economic hurdles to doing that, regulation.

(42:45):

Anti money laundering is one that gets thrown up in front of it. You can see what the government's trying to do right now, Biden administration to try to stop crypto. They're scared of that. They're scared of it becoming something that threatens the dollar.

Bill Walton (43:02):

Dollar. What do you make of the fact that the Chinese are now allowing all the crypto companies to begin to thrive again in Hong Kong?

Norbert Michel (43:10):

Oh, okay. Now you're ahead of me there. I know that they've banned them in China. And I know that. But...

Bill Walton (43:15):

Well, they banned them, but I think now they're making mischief.

Norbert Michel (43:19):

Okay.

Bill Walton (43:19):

Now that we're having our own banking issues, I think they clearly don't want it for... They're not going to let it happen in China, but they'd love to have it happen every place else so that they can be disruptive. And they've really put in Hong Kong, which is no longer free, now really been tucked in the Chinese Communist Party. That's a mouthful. Anyway, CCP. I think they're out mischief making.

Norbert Michel (43:51):

Oh, okay. No, I didn't hear this. I didn't know. I didn't realize that that was a thing. I'm not saying you're wrong. I just didn't. That one is new to me.

Bill Walton (43:59):

Okay, well...

Norbert Michel (44:00):

But the more private alternatives we have to the state backed or non backed currencies, the better. And I think that that's a policy goal that's worthy of having. Which is to have a framework that allows those things to flourish.

Bill Walton (44:19):

Okay, we've got to wrap up.

Norbert Michel (44:20):

Okay.

Bill Walton (44:21):

Let me direct us to some reading assignments. So if we've ticked off people's interest in this and you want to follow up, we can't cover all this complicated stuff in 40, 45 minutes. What should people be reading?

Norbert Michel (44:37):

The first place I would go, and it'll have a whole bunch of other things that you can read is Cato's, it's my group's, our CMFA. Center for Monetary and Financial Alternatives. We have a policy guide for the 118th Congress. And that's on the web. So it's called, Sound Financial Policy.

Bill Walton (44:57):

Good.

Norbert Michel (44:57):

It's on our website.

Bill Walton (44:59):

Okay.

Norbert Michel (44:59):

If you just find me on the website, you'll find all of this stuff.

Bill Walton (45:02):

Well, that's why you're here. I sort of count on you to give me a libertarian free market view about what our money ought to be about. So thanks a lot.

Norbert Michel (45:09):

Thank you. Thanks for having me.

Bill Walton (45:10):

It's really fun. So anyway, this has been the Bill Walton Show with Norbert Michel of the Cato Institute, and we've been trying to talk through and think through our money and what we had to do with it. And I think he's pointing us in a great direction to take a look at the Cato website if you really want to dig into this and learn what's at stake. And there's a lot at stake, particularly with the central bank digital currencies. That's something we cannot let happen.

(45:37):

So anyway, hope you enjoyed our show, and as usual, we welcome your comments either on Substack or on the website or on YouTube or Rumble or all the other podcast platforms where the show appears. We take your comments quite seriously. We like to do shows that you're curious about and talk with people you're interested in. So send us your comments and thanks for joining. And we'll be talking with you again soon. So take care.

(46:05):

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