Part One

# AN ECONOMY IN TROUBLE

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# Chapter 1

# Doug Casey on Bernanke: Be Afraid, Be Very Afraid (Part One)

## December 8, 2010

**Louis:** Thanks for the link to the "historic" Ben Bernanke interview*. It was breathtaking to hear the man who didn't see the crash of 2008 coming say he's "100 percent confident" he can control the U.S. economy. What do you make of that—is it hubris or stupidity?

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* The following conversations were originally published online and were peppered with hyperlinks to additional material we believed readers would want to reach. In this print edition of *Right on the Money*, we've retained the hyperlinks in ghost fashion. You can follow any link that interests you by visiting www.rightonthemoneybook.com. There you'll find all the online links that the book refers to, laid out conversation by conversation, just as they appear in the book.

**Doug:** As *60 Minutes* pointed out, it's rare for a Fed chairman to give an interview; this was only Bernanke's second—here's a link to his first. It's such an unusual thing that I think it's a sign that the Powers That Be are really quite worried. As they should be. His last interview was at the height of the crisis in early 2009.

**L:** Bernanke himself looked worried. I was amazed, actually, watching the interview, by just how nervous and stressed he appeared. He stuttered, his lip quivered continuously, and that pulsing vein on his forehead really stood out throughout the interview. He looked like he was flat-out lying and doubted anyone would believe him, but had no choice but to keep lying. It was almost like a cartoon of a liar caught red-handed. It's a shocker that the Powers That Be would let such an interview be aired—it would seem to be the opposite of reassuring, to me.

**D:** I know. It'd be nice to run that interview through a voice stress analyzer and see what it says. It's a question of whether he's a knave or a fool—neither answer is bullish for the U.S. economy. He'd be wonderful to play poker against.

He's not a skilled or enthusiastic liar, but he is certainly becoming more practiced at it, which is, of course, par for the course of being Fed chairman. That aside, the interview is really interesting, because there are several times in the interview when he really comes across as being scared and warning people: the way he stressed how close to the edge of a precipice the economy was, and how troubled it remains.

**L:** Well, that was the reason given for the interview. He says the critics of his latest $600 billion shot in the economy's arm don't understand how serious things are, how dangerous the high unemployment rate is.

**D:** Yes, of course he'd say that. You know my argument is that "doing something" is a mistake, if it's based on incorrect economics. Everything they are doing is not just the wrong thing, it's the opposite of the right thing.

**L:** So, do you believe Bernanke was actually lying? Or was he just highly stressed, because he's the one in the hot seat, and he knows that just because the *Titanic* didn't sink the moment it hit the iceberg, that doesn't mean it's out of danger?

**D:** Perhaps it's a bit like Hitler in the bunker, who was under great stress, and really wasn't lying when he insisted that the Third Reich could still win the war. In fact, I can't wait to see if someone does one of those "Hitler in the bunker" spoofs, based on this interview.

**L:** I wouldn't be surprised to see one posted on YouTube tomorrow. Meantime, Jon Stewart skewers Bernanke admirably in a recent skit on his show.

**D:** Actually, someone just did one of those "Hitler in the bunker" spoofs on manipulation of the silver market—which, incidentally, I don't believe is a reality. But it mentions our redoubt at La Estancia de Cafayate. There's a lot of very rich and colorful language, which some people won't like, but it's very funny.

**L:** Warning to readers: That video is not family-friendly. So, lying aside, let's look at some of the things he said. The first and foremost thing that jumps out at me is that he says the Fed is "not printing money" and that the Fed's actions have no significant impact on money supply. How can he imagine they can inject liquidity into the economy, and that it won't have any impact on money supply?

**D:** I think he knows better than that. Look, what the Fed has been doing is buying securities. And the way they do that is to credit the account of the seller with dollars. So, of course it creates money. That's why they call it "quantitative easing"—because they're increasing the number of Federal Reserve units in circulation. I really love that term, QE, because it's so cynically dishonest, like the whole monetary system itself. And it's amazing that nobody even challenges it. They just accept it instead of calling it what it is—printing money. It's Orwellian.

In any event, creating more currency units by buying government bonds serves several purposes, from their point of view. It raises the prices of bonds, and therefore pushes interest rates down—and they want lower rates because it makes it easier to finance the staggering amount of debt out there that threatens to collapse the system. And they want more currency units out there because that makes people feel richer, consume more, and that props up preexisting economic conditions—which are actually unsustainable. The crash prompted them to buy toxic paper from banks for a while, to keep them from going under. Now they're buying U.S. treasuries again, with the latest $600 billion.

Bernanke is taking desperate measures to solve an acute problem. But their consequences will be disastrous—much, much more damaging than if he'd done nothing. Of course if he did nothing, the system would collapse through a deflation: bonds would default, banks would close. What will now happen is the currency itself is going to be destroyed, which is much worse. But since it's put off a bit further in the future, that's the course he's taking.

**L:** Agreed. In spite of what Bernanke says, whatever the sellers of the securities do with the new dollars deposited to their accounts—even if they leave them on deposit with the Fed because the Fed is now paying interest for excess reserves—it still frees up other money the sellers can now use for other purposes. And because of the fractional reserve system, there's a multiplier effect on the added liquidity. Bernanke says that all he's doing is keeping interest rates down to stimulate the economy, but the way he's doing it adds to the money supply.

**D:** Exactly. We're beyond the time when you have to cut down trees to print up hundred dollar bills. It's just a keystroke, now. But playing with the amount of currency doesn't create new wealth—it actually makes real wealth creation much harder.

So as the situation gets more serious in the months and years to come, you can expect ever more ad-hoc measures from the government. They'll probably try capital controls, to keep people from transferring wealth outside the U.S. Those will be popular because only "unpatriotic" people would do such a thing, as well as rich people—and it's now time to eat the rich. They'll likely require all pension plans to buy a certain amount of government securities. They'll have restrictions on the amount you can spend on foreign travel. They'll probably even try price controls, like Nixon did in the early 1970s. They'll increasingly limit what can be done with cash—like the new requirement that all transactions of any type above $600 must be reported on 1099s—because digital money is much easier to control. New government bureaucracies will be set up to enforce all these things, and many more.

**L:** Scary. Does it mean anything for Bernanke to say that the $600 billion came from the Fed's "own reserves"? Where would the Fed's reserves come from, if not from electronic dollars newly created at the stroke of a computer key?

**D:** No. That's a cynical lie. I think what he was trying to stress was that the money was not coming directly from taxes. The Federal Reserve is a misnomer. There is no reserve, as there was in the days when the gold at Fort Knox backed the dollar. Now, the dollar isn't backed by anything, so there's nothing to reserve—they can and do create as many dollars as they want, as ledger entries, which they can and do use to pay banks and others, who can and do use them to pay others, and so forth.

It's not a "reserve," and it's not "federal." Although the Fed is a creature of the government, it's not, technically speaking, part of it. It's really controlled by the large banks, who benefit primarily through "fractional reserve" banking. In the past, when banks were just ordinary businesses that warehoused money and acted as brokers for loans made with savings, keeping a fractional reserve was a fraudulent practice that would eventually result in bankruptcy, followed by criminal charges. The creation of central banks, like the Fed, facilitated it as common practice; in effect, debt became a form of money. This isn't the forum to explain the subject in detail; I've done that in my books. But we've now reached the inevitable consequence of the system, which is a financial cataclysm. Bernanke is trying to forestall the inevitable, and in the process is making it worse. As Louis XV correctly observed, "Après moi, le déluge."

**L:** Deluge indeed. You can see the out of control growth of what they are doing in any M2 money supply chart.

**Ancha Casey** [Doug's wife]: Mfinmmf mmmfmf.

**L:** Hi Ancha—I didn't catch that.

**Ancha** [Leaning closer to Doug's mic]: Hi Lobo. That growth of money supply erodes purchasing power. One peso here in Argentina today is worth one trillionth—literally—of its value at the beginning of the twentieth century.

**D:** Yes. It really amounts to an indirect form of taxation: As more dollars are created, they dilute the purchasing power of the dollars already in existence—though we call it inflation. The first organizations and people to get those dollars are able to spend them at their old value. And, of course, the government—which is not the country or the people, but a group with its own identity and interests—gets to spend as many as it wants on what it wants. And now the numbers are moving into the trillions. Obama may soon have to ask his science advisor what comes after "trillion." It's all a charade.

**L:** Inflation is taxation through dilution. But most modern economists don't think inflation is the result of excess at the printing press, so whether Bernanke is lying, or just doesn't see the danger of what he's doing, it doesn't look good.

**D:** That's right. Most economists blame inflation on the butcher, the baker, or the candlestick maker raising their prices for other reasons than the loss of purchasing power of the currency. They attribute inflation to "greed" on the part of producers and workers.

The problem is a totally fallacious basic theory of economics. Almost all the "economists" coming out of school today aren't actually economists. An economist is someone who describes the way the world works. But these people—Bernanke being a perfect example—aren't interested in describing the way it works. Rather, they want to *prescribe* the way they want it to work, and then get the state to enforce their views on society. The state, of course, welcomes such advice when it serves its agenda.

Bernanke has a high IQ, but he's just an uninteresting and unoriginal suit. He grew up with the reigning orthodoxy, got his PhD in it, taught it, and has been rewarded with the leadership of the world's largest central bank. But he's not an economist. He's a political apologist. And, I suspect, he's now a very confused and scared one. Perhaps he can see that the ridiculous theories he's grown up believing in are more phony than a Federal Reserve note. But he doesn't dare admit it.

**L:** Maybe we could buy one of the thousands of mirrors in Mugabe's house in Zimbabwe and send it to Bernanke, as a gift. To look at himself, and perhaps see where the problem lies.

**D:** It won't help. The fundamental problem we have is an unsound money system, and no amount of fiddling with it will make it work well over any extended period of time. All fiat currencies follow one of two paths. One is when they keep printing more money to keep the ball rolling, which is what Bernanke's doing. Or they stop printing money, in which case banks go bust, insurance companies go bust, and all sorts of corporations go bust, throwing the economy into a catastrophic deflation. The latter is the better alternative, sad to say.

There's no painless way out of this, at this point. Bernanke is caught between the Scylla of deflation, which would liquidate the inefficient part of the economy, and the Charybdis of inflation. He's chosen Charybdis—the whirlpool—which will take the whole economy down.

**L:** Bernanke did specifically say in his interview that the Fed had to take action because there was a serious threat of deflation, which was the problem with the Great Depression.

**D:** Bernanke is afraid of deflation, because at this late stage, it would be extremely dramatic and immediate. In a free-market economy, neither monetary inflation or deflation are realistic problems, because gold is used as money, and the supply typically rises by only a small amount every year—and it almost never declines. But deflation is actually a good thing. Deflation may cause some wealth to change ownership, as any change can, but deflation does not destroy wealth, as inflation does. And deflation can be a very good thing because when dollars are worth more over time, it encourages people to save—and one of our big problems is that nobody's saving. People don't save because today's artificially low interest rates are beneath the actual inflation rate, so of course nobody wants to save. But the only way to become wealthy is to produce more than you consume and save the difference. Banks can't make loans unless, first, there are savings. This makes deflation's reward to savers a very important positive.

**L:** Bernanke says that falling prices would lead to lower wages, which would send the whole economy into decline.

**D:** That's an old fallacy. If all prices fall, including the price of labor, so does the cost of living, and no one is worse off. The price of labor would have to fall faster than the price of food, rent, et cetera for people to be hurt, and it does not follow automatically that this would be the case. If the butcher doesn't have to spend so much for bread, maybe he doesn't have to charge the baker so much, and both might be able to put aside a little more to save up for new goods from the candlestick maker, or to invest, or to create new businesses, and hire more people, which could actually drive wages up.

**L:** Wages may be influenced by inflation or deflation, but are not really set by them. What determines wages is productivity; how much value does the laborer create, and what can he or she trade for that value?

**D:** Exactly. And you get increases in productivity from capital creation, which arises from saving and investment. What this all boils down to is that you can't create wealth by printing money. That just debases wealth and distorts the economy.

**L:** Seems hard to believe Bernanke can't understand such a simple thing.

**D:** Well, the whole system is so precarious at this point that it may be quite accurate to label the Fed's actions as "panic." [Bernanke] said several times in the interview that he had to act—"aggressively" and "proactively"—to save the system. But you can't save a system that's built on quicksand—a fiat currency. The whole thing ought to be flushed away, along with the whole crazy-quilt work of Keynsian economics that most students are educated in. It's strange. It took the catastrophic collapse of the USSR and other socialist states to prove to all but the most dogmatic ideologues that Marxism was a sociopathic scam. It may take the collapse of the United States and the Western world to put the lie to Keynes. If so, then the sooner the better.

**L:** A lot of people would go down with that ship.

**D:** Yes. The whole business of the United States, its "consumer economy," has really become banking and finance. Everyone is buying and selling and trading electronic ghosts in between institutions, derivatives piled on derivatives, all magnified by the fractional reserve system. Or they provide services to those who do, paid for with meaningless accounting fictions that go back to the banks to pay for maxed-out credit cards. Nobody's thinking of actually producing things of value. The whole thing is a completely ridiculous house of financial cards.

People have forgotten the basics of banking, which are that a bank was a place where you deposited real money—mostly gold. There were time deposits (savings) and demand deposits (checking). The banks paid you some small amount when you deposited savings for some agreed upon period of time, typically about 3 percent, and made money lending it out at 6 percent. And banks charged you a small fee for the service of keeping your demand deposits liquid and paying them out to you or to whomever you gave your bank notes, or checks. That was it; banking was and should be no more exotic than a pawn shop.

But nobody believes this is the way things should be anymore; there's no way back without hitting the reset button. That's why I think the whole system has to—and will—collapse.

**L:** So you're not buying Bernanke's line that they are simply lowering interest rates to stimulate economic growth?

**D:** No. Aside from the fact that paying for this stimulation increases the money supply, stimulating growth through artificially low interest rates is the opposite of what they should be doing. It encourages debt and spending—living beyond your means, which is what the whole country has been doing for decades. They shouldn't be in a position to do anything—the Fed should be abolished. But, if anything, they should be raising interest rates to encourage savings. That's how wealth is accumulated, and wealth is what's needed to invest in new businesses and technologies, not to mention keeping yourself alive.

**L:** And unfortunately, in lowering rates to stimulate the economy, Bernanke is simply following the recipes of mainstream economists, so there seems to be little chance that he or anyone in power will realize the disastrous course they are on.

**D:** The chances are Slim and None, and Slim's out of town. The trouble with mainstream economics, the way it's taught in most colleges today, is that it's like sociology, or English literature, or gender studies: It's based on theoretical castles built in the air—no reality whatsoever. And [this is] of negative value in the real world. But, fortunately, the education system we suffer with today will also likely be washed away in the deluge.

**L:** That reminds me of the part of the interview in which Bernanke was asked if the Fed would be able to rein inflation in, should it appear. It was one of two questions he jumped on without hesitation, saying that inflation was not a problem. He could raise interest rates in 15 minutes, if necessary, and that would quash inflation. Made me wonder what planet he was living on, to imagine that after he's gone down the path of Mugabe, simply raising interest rates would restore purchasing power to the dollar. Even in recent memory in the United States, we've had high inflation *and* high interest rates—we call it *stagflation.* How could he not know this?

**D:** It just goes to show what a bad economist Bernanke is. The whole science of economics is not about seeing the immediate, direct, and obvious effects of any given economic policy—a smart six-year-old can do that. It's about seeing the indirect, hidden, and long-term effects of that policy. If the Fed goes into the bond market and buys a trillion dollars' worth of bonds, the short-term and fairly straightforward effect will be for bond prices to go up and interest rates to go down. But the indirect and delayed effects from the creation of a trillion more currency units are inflationary, and eventually it will force even the interest rates back up again, because people won't lend unless they can charge a rate that will more than make up for the lost purchasing power of the inflated currency.

**L:** The seen and the unseen. Is it possible that Professor Bernanke has never read Bastiat?

**D:** [Laughs] Don't make me laugh. That's old-fashioned stuff, Lobo. The Great Depression disproved classical economics, don't you know? Now we have new economics—all built on quicksand, as I say, and that means the whole house of cards is doomed.