Richard Werner: A Whistle-Stop Tour Of Modern Banking

Ross Welcome to Renegade Inc. Last week, we spoke with Professor Richard Werner about how temporary QE has become a permanent problem. This week we cover all things banking with Professor Werner - Japanification, the Weimar Republic, central bank digital currencies, credit creation, the war on cash, crypto, gold and, of course, the date of the next crash. But most importantly, we also cover your personal sovereignty.

Ross Welcome to Renegade Inc. We are here with Professor Richard Werner. Richard, welcome back. Part two. This is going to be a lot more rat-a-tat. I'm going to ping some questions at you - short and sharp. We had that long and brilliant explanation of why QE, why the House of Lords are worried about it, why everyone's starting to worry about inflation and why it's been scatter-gun instead of targeted QE. You've nailed it. Everyone always mentions Japan, you know, the West is turning Japanese. Is that correct to say that?

Richard Werner Well, it's always good to compare two historical examples and other countries. And we need to look at the right comparison for the right scenario. Certainly 2008 and the policies before and afterwards, I think that it was quite useful to compare with Japan.

Ross Right, now?

Richard Werner At the moment. I mean, in Japan, essentially, we've had deflation because bank credit creation was zero or negative. I mean, I was like a stuck record when I was in Japan. You know, we need to expand bank credit for GDP transactions, business investment. But it took until 2013 for them to finally increase bank credit to the real economy, which is quite crazy. And that's when GDP started to expand. So, the period before, therefore, because bank credit was negative and was not expanding was a period of low growth and deflation. So that's where it's not a relevant comparison because of course, that's not our problem. The problem at the moment is not that bank credit is not growing and is negative. We've had since 2020, March onwards, booming bank credit growth. And therefore, the problem is on the other side, is more on the inflation side.

Ross Right. So are you surprised when bank central bankers now look surprised that this inflation has arrived?

Richard Werner Well, no. I mean, I warned, if you check my my Twitter feed at Scientific Econ or Professor Werner, I mean, my warnings came out last year, April, that it's going to be inflationary. There will be inflation. Actually on this point...

Ross Transitory?

Richard Werner Well, that is the question. Of course, at the time you couldn't tell because it depends on whether the bank credit creation and central bank credit creation would continue. And at the time, we only had this massive injection and massive expansion. And the latest update is that they have actually reduced bank credit creation and also the central banks have reduced their liquidity injections compared to a year ago. And therefore, it looks like we're not heading into a Weimar- style galloping inflation, which is good news. But clearly there is an inflationary shock and it will now depend on the policies as we move forward, whether this inflation will disappear again or get entrenched or then accelerate. So it's a policy matter. We can get any of these scenarios, depending on the policies taken. It is always in the power of the policymakers.

Ross That was the next question. Is it helpful to constantly transpose Weimar Germany on what we're going through today? Because you see it so many times. You certainly see on social media people walking around with wheelbarrows full of notes and they say we're going to have hyperinflation. In fact, worse, we're going to be Zimbabwe.

Richard Werner Well, it doesn't hurt to keep it in mind, but also it is relevant because if you analyse the Weimar period, you'd be aware that this was a policy decision. It was the policy makers. It was the central bank deciding to do this. And so that is something we should always keep in mind, that central banks and other central planners and governments and policymakers, you know, they make those policies and sometimes they lead to disastrous outcomes. That's why we need the scrutiny and that's why it's welcome that the House of Lords is actually examining what central banks are doing and those policies. We always need that scrutiny because even in the Weimar period, it was a policy decision. It was like, oh, suddenly hyperinflation happened by accident. No.

Ross No, it was man-made. And there was a rationale behind it.

Richard Werner That's right. And that, of course, is is certainly the relevant part we should look at. But otherwise, I don't think the Weimar era is really the great comparison, because what really happened last year, 2020, from March onwards, is something that's much more akin to Stalinist Soviet Union- type scenarios. That's what we need to compare it to.

Ross Why, because it's so centrally planned?

Richard Werner Well, what we have is massive intervention by the government in the economy by introducing restrictions on so many parts of the economy as we've never seen before in the UK.

Ross Ironic from a free market.

Richard Werner Absolutely. It's never been done before ever in the UK. There's other countries where it has been done before, like Russia, Soviet Union, Germany, East Germany and also earlier periods in Germany. So in other countries, there are precedents, but in the U.K. it is unprecedented and we have to compare it to Stalinist Soviet Union type of drastic across the board interventions and then think about inflation, because that is a different scenario. Namely, the central planners will introduce all sorts of further central planning measures if they want to, if inflation becomes a problem. I mean, the parallels are there - queues, you know, big queues. Well, that's also what they had in the central planning Soviet Union, big queues everywhere, people not allowed to do certain trades because the government is forbidding them. Well, go to Stalinist Soviet Union.

Ross Price controls?

Richard Werner And so that's the next one. I was going to say price controls. you see, comes next. Of course, as the Covid agenda smoothly sort of morphs into the climate change prevention agenda, and we've got these 2030 targets for all sorts of things, CO2 emissions. We have a problem whereby we're supposed to switch all the cars to electric cars. But the electricity supply in the world is not large enough to do this. Well, that's not a problem.

Ross Why?

Richard Werner If you look at, you know, the right comparison and it's not Weimar Germany, it is Stalinist type Soviet Union. In the Soviet Union, they had cars, but not everyone had a car.

Ross Exactly.

Richard Werner If you were a member of the Politburo and the party cadre, then you had a car. If you were an ordinary person, well, public transport is good enough for you, isn't it?

Ross You paint a bleak but realistic picture. Is there a war on cash?

Richard Werner There is.

Ross Are you sure about that?

Richard Werner Yes.

Ross OK, and let me qualify it, because when you talk about a war on cash, are you talking globally or are you talking more USA, Canada, Western Europe, Australia, New Zealand?

Richard Werner I think it's global. The tendencies they're global.

Ross The tendencies they're global. Can I just push back a little bit? Because if you think about those territories I mentioned, that's 8.6 per cent of the world's population. The world's population is 7.6 billion or thereabouts, give or take. In the rest of the world, cash to me seems to be absolutely flying.

Richard Werner Unfortunately not. Look at India, which, of course, is the second most populous country in the world. We've got almost a billion people there. The government introduced another central planning exercise in 2016, the so-called demonetisation, where suddenly the government declares these and these banknotes will be invalid within three days. And of course, we're talking about a country where there's literally millions of people in rural areas. They don't even get this information in time. And those who do have to scramble to go to some bank where they don't even have an account, then they first have to open a bank account, which now has become much more difficult because you need to join the ADHA electronic ID system first. So creating huge bureaucratic nightmares. As a result, a lot of very poor people, in particular, that had their wealth in the form of cash lost their fortunes - well, the tiny savings they had. And therefore destitution, poverty and starvation were the result of this war on cash we saw in India. And if they could do this in a developing country, of course, they can do it anywhere. So a war on cash is real, but is this really the right way to go? Is cash really such a bad thing? I don't think so. Cash is a very resilient tool. It's a simple tool that should be maintained. So I've been recommending and been joining this campaign, Cash on Fridays. On Fridays, we don't do any electronic payments. We pay in cash only. We should actually do this.

Ross The Germans still love cash.

Richard Werner Yes, Germans, Japanese and some countries, cash is still quite popular. But even there we see the centralising forces, for example, limiting by law the maximum amount of transactions that can be paid in cash. Why are you doing this? If it's legal tender, why do we limit it at 3,000 euros or something?

Ross If central banks want a central bank digital currency, which, if you listen to the rhetoric they do, why haven't they been able to design, create and implement one?

Richard Werner Well, I don't think there's a problem there. I think they can design and implement one. The technology is not rocket science, and so that's not why we don't have it yet. I think the implications for the economy and society are so vast that they realise they need to build a stronger consensus first before they unleash this tool, which will be potentially enormous and dramatic in its impact on society, not just the economy, on society, because some central banks are proposing central bank digital currencies that aren't really currencies. They're essentially surveillance and control tools that have frightening totalitarian aspects to them and at the same time undermine the banking system by driving banks out of business. But other central banks - and so it's good that there are different forms of this - have been working on central bank digital currencies that don't have these frightening negative aspects. And ironically, one of those central banks is the Chinese Central Bank, and it has its digital currency already in place. Now, a key design difference to some of the other central bank currencies that are being proposed, concerns the role of the banks. Now, here, we have to remind ourselves that a lot of this rhetoric is slightly misleading. You know, they're called central bank digital currencies, as if we haven't been using digital currencies. We've already been using BDC, bank digital currencies, for decades. So we really have digital currencies. So that's not the innovation. What is the innovation? Well, the innovation in some proposed central bank digital currencies is that banks will disappear as they're driven out of business by the central bank, which of course, is the system we had in the Soviet Union, Soviet model, where one ghost bank controls everything. But is this really what we want? Well, the Chinese Central Bank, because they have a more recent history of turning away from the Soviet model to an alternative model of decentralised banking, they've made sure that the Chinese central bank digital currency continues the current relationship between the banks and the central bank, whereby the central bank is in a way, a wholesale bank dealing with the banks, but not with the public. And the banks deal with the public. And so it's possible to design central bank digital currency for this to continue and for banks to continue to create credit and be the credit creators in the economy, while the central bank also has a digital tool dealing only with the bank. So that design is possible. So why don't we discuss that - the different design possibilities? Because with that design, you will not kill the banks and you will continue to have, therefore, the potential of high economic growth and small firms doing well, because if you get rid of banks, it gets worse. I mean, in the UK already we only have five big banks dominating banking. Small firms, therefore, don't get enough credit. If you further centralise - and then there's only the central bank - that's not really where we want to go. And it contradicts the Bank of England policy to have more banks.

Ross And that's exactly what we're going to discuss in the second part.

Richard Werner Excellent.

Ross Welcome back to Renegade Inc. I'm here with Richard Werner. Richard, welcome. We have elegantly come out of talking about a war on cash to why central bank digital currencies haven't been implemented. But what you're saying is you have to make a differentiation between a central bank digital currency and a bank digital currency and how you target this. Explain.

Richard Werner Yes. And also, there's different types of central bank digital currencies possible. There's the good type and there's the bad type.

Ross Right.

Richard Werner And therefore, we need this discussion. What type of central bank digital currency do we want. At the moment what we have is some central banks like the ECB, in my view, playing this old trick of the car salesman saying, which colour do you want the car when actually you really think, do I need this car? And so really, we need to discuss, do we need central bank digital currencies? And then if we want them or for what purpose and how should they be designed because they can be very, very different?

Ross Well, taking your analysis, if you have all these intermediaries in the form of the banks and you can't get the money through the banks and into the real economy, a central bank digital currency surely should go and stand alone and feed the real economy so we can get enterprise moving, you can lessen inequality, you can get society moving, fund innovation and all the good things that we need. Surely that's what you do. You get rid of the finance curse. You get rid of the City, you bypass that and inject it straight into the real economy.

Richard Werner I can see the attraction of that if you have a very concentrated banking system dominated by big banks and then you say, well, they haven't been doing a good job, so let's have a new tool, let's go directly. But you still have this problem, then, how is this central bank, if the central bank directly is now injecting money, going to select the companies and especially small firms that need to be lent money to a newly created money because then you get economic growth without inflation?

Ross People's QE.

Richard Werner If they're given existing money, then it won't lead to economic growth, you see. So it needs to be newly created money. And in some proposals, people are saying, let's take away the power to create money from the banks and have a monopoly in the central bank. Now, that would mean no more economic growth, and that's the end of prosperity for the majority of the population. That's why we don't want a centralised system where the central bank is the only creator of money. The decentralised system where banks create money is actually superior.

Ross But maybe we're looking in the wrong place. Maybe we're looking at central banks and thinking they're all powerful, but actually their hands are tied. They haven't been able to implement a currency. There is one company, reading Professor Jan Kregel's stuff, and he talks about the Webtelmobi system and he quotes, 'The system removes the requirement for the consideration of SDRs, CBDCs and other proposed methods for reform of the global economic and financial systems.' Big statement. Isn't it ironic that a telephony business can come up and mirror the financial system and then actually people can interact by using their products?

Richard Werner Yes, although we would need to check, you know, who is doing the money creation in any alternative proposed system. Because at the moment, money is created by banks and as far as the general public's concerned, it's essentially almost entirely the banks, not the central bank.

Ross But credit can also be created by a telephony company.

Richard Werner Well, if you want a system where, you know, non-banks create money and companies that have different specialisations, create money. But to come back to this principle, you get high economic growth if the money creation is linked to new technologies that are highly productive and efficient, they should be funded with new money creation. That's the principle. And that's why when you have a system where banks specialise in lending to productive SMEs, you get very, very high economic growth. Now, if other firms are allowed to create money, let's say, you know, because we could design a system where others also create money, how do we make sure that it's this money is newly created in order to implement new technologies and new ideas that have value added and increase productivity? If we can do that. That is fine. But if not, then we have a problem.

Ross The first principle is not to create a fractional reserve banking. You have one for one...

Richard Werner So then in that system, who creates the money supply?

Ross The company can. Surely they can issue credit?

Richard Werner Well, no. Non-banks can't create money. They can only reallocate existing money.

Ross But that's exactly what we're doing. And then that money, for instance, on the Webtelmobi offering that money then gets directed amongst SME owners, people who are unbanked or whatever it is. But it is an interesting idea, isn't it, that a telephony company can come up and do this whilst the central banks have been trying for years and haven't been able to succeed?

Richard Werner Well, I'd have to have a look. But essentially a problem with a lot of these proposals is that they're arguing, let's abolish bank credit creation and let's have the money creation power in the hands of one player, but then that becomes even more centralised.

Ross But Mr Kregel, Professor Kregel, says, 'The WM system therefore represents an operation of a fully functioning global financial system which does not reform the existing one, but rather functions in parallel to it and has the capacity to replace it.' That's quite interesting, isn't it, that something can pilot fish alongside the whale, if you like...

Richard Werner Well, one has to check it. The key question one needs to ask is who in that proposed system is creating money? How is that limited to which players and under what conditions? And that determines whether it's going to be a successful system where we have growth and prosperity. Often these proposals are done without credit creation in mind. And then it turns out when you analyse it, actually you guys have no money creation in there. It's just reallocation of existing resources. And that way you will not get any economic growth. And then we have a problem.

Ross It brings us neatly to crypto, I have to mention it, Bitcoin. What are your views?

Richard Werner These cryptocurrencies, digital currencies, I think they serve a purpose at the moment.

Ross Has it been an educational purpose?

Richard Werner Yes. Yes, exactly - an educational and partly PR purpose to get people used to the idea that they could be digital currencies, just like in the future when we have central bank digital currencies. So that's, I think, one purpose actually that there's this educational purpose. And the other purpose is to, in my view, in a very difficult time period since 2008 and also now, Covid, all sorts of restrictive Stalinist-style government policies in many countries and central banks creating a lot of money since I mean, last year in particular. Normally, what you'd expect is the gold price to go up a lot because in crisis situations, when there's big changes in the economy and society there's stability. But the gold price hasn't moved. Of course, there's a lot of evidence that the gold price is largely manipulated and kept artificially low and to maintain that, because once the gold price spirals out of control, it's game over because people realise what's happening. So I think it's important to keep it under control for certain policy makers. And to do that, you need an outlet. You need a modern version of gold. And I think the purpose of the Bitcoin and other cryptocurrencies is to serve as a sort of digital gold so there's not so much pressure on the gold price.

Ross Really interesting. So that's been a release valve whose capital has gone into there. And then Bitcoin, which is a digital whatever in a wallet has become that store of wealth?

Richard Werner Yes.

Ross What are the Basel three regulations and what effect will they have?

Richard Werner The Basel three regulations are the update of Basel two, which was the update of Basel one. That's the shortest answer.

Ross Thank you. Okay. Next one.

Richard Werner And all of them have in common that they assume that banks are just financial intermediaries that gather deposits and lend out the money.

Ross Are we still there?

Richard Werner Yes, and they restrict the power of banks to create money only indirectly because they don't directly recognise it by having capital adequacy rules. But capital adequacy is not really a sufficient tool to make sure that bank credit creation is as large as it should be to support the economy and is allocated mainly for the real economy. So it's a very crude regulatory tool that doesn't really serve the purpose that we should be aiming at, namely, to make sure we have high economic growth without inflation and without crises.

Ross I'll save the best to last. Interest rates. We are in a mess, aren't we? Talk us through how we've capitulated when it comes to interest rates-setting.

Richard Werner At the moment, in some countries, central banks still want to be helping the economy. They want to stimulate the economy. And the knee jerk reaction by central banks over the last 50 years has been, well, if you want to help the economy, we should lower interest rates. Now, in economics, there's many different schools of thought and they famously disagree and argue, but they all agree on one point, namely - and that's the point that central banks keep repeating - if we lower interest rates, we get higher economic growth. If we raise rates, we slow growth.

Ross Now, you disagree with this?

Richard Werner I do.

Ross Tell me why.

Richard Werner I'm an empirically-based scientific researcher and there's no empirical evidence for this. Where does this story come from? It comes from theory. It's entirely theoretical.

Ross You shock me. Economists going only on theory for 200 hundred years.

Richard Werner Exactly. That's why we don't have progress. So I did the first empirical test of the one thing that all modern economics agrees on, namely, that we have a negative correlation between interest rates and growth - lower rates lead to higher growth, higher rates lead to lower growth, and that there's causation from interest rates to economic growth. Can you believe this? This is probably the most frequently cited policy by central banks and macro policy makers over the last 50 years in the whole world in history, you know, this relationship between interest rates and growth. But how many empirical studies have they done to demonstrate this result?

Ross Zero. I was going to go zero. I've learnt now. I've learnt. Fantastic.

Richard Werner But I did the first study, so it's out now.

Ross Well done. And the result?

Richard Werner The result is that the truth of how interest rates and the economy relate to each other is diametrically opposed to what 200 years of modern economics of all different schools have all agreed on, namely, interest rates and economic growth are not negatively correlated. It is not lower rates and higher growth go together, higher rates and lower growth. No, it's the opposite. It's a positive correlation. Higher rates and higher growth, lower rates and lower growth. And secondly, the causation because economics says if we change rates, that will affect the economy, so causation from interest rates to the economy. The empirical evidence is causation runs the other way. Economic growth is driving interest rates and is a positive correlation. If you get more growth, you get higher rates. If you get less growth, you get lower rates. That raises a number of questions like why do central banks keep going on about interest rates when they can't really be a good policy tool? And secondly, what actually drives economic growth then? Because it's not interest rates, of course, it's credit creation, bank credit creation.

Ross Of course it is. And with your theory, this theory, you also stop banking crises because you stop all the capital gains going up. You head off your Minsky moment.

Richard Werner Exactly.

Ross And savers get a return on their money. What's not to like?

Richard Werner Exactly.

Ross When's the next crash going to happen? And we need a date. We need a time. We need a moment. We need to know exactly how it's going to pan out. And we're going to hold you to all of it.

Richard Werner I can tell you it is when bank credit creation for non GDP transactions, which means asset purchases, is going to slow to zero and then contract. That's when the asset price boom will end and then we will get a banking crisis.

Ross Very deft. Final, final, question. People are worried about personal sovereignty now. They're worried about independence. They see what's happening in the world. They see how the media are reporting it. What's the one thing that you'd say to people watching this who are concerned about personal sovereignty and their independence and their economic well-being? How best do they go about protecting that and looking after the people dearest to them.

Richard Werner I think it's time to speak up. You know, when Soviet-style and Stalinist-style policies are being introduced, it's time to speak up, remind everyone of what in England since the Magna Carta has been enshrined in law, that there should be certain freedoms and governments should not be allowed to take them away. And people have been going out on the streets, but the media just don't report these huge demonstrations we've had in London, probably a million or more, and that's what we need to do. We also, you know, if we cannot change things because parliament seems to have shut down March last year, there's no opposition, then it's time to move to a country where there is more freedom. When did people leave the Soviet Union because it became too restrictive? When did people leave Nazi

Germany because of it getting too restrictive? You know, there was a time-window when that was necessary.

Ross Professor Richard Werner, always a pleasure. Thank you very much for your time.

Richard Werner Thank you.

Ross That's it from Renegade Inc, this week. You can send the team a mail - studio@renegadeinc.com. Join us next week for more insight from those people who are thinking differently. But until then, stay curious.