Episode 017: Understanding Austrian and Keynesian Economics

Todd: [0:00:18] Hey everybody, welcome to another edition of The Prosperity Podcast, this is no BS Money Guy Todd Strobel. Once again, we have our wonderful cohost, bestselling financial author Kim Butler, welcome Kim.

Kim: Thank you Todd, happy to be here today.

Todd: Today we're gonna be talking about Austrian economics and this is kind of a word that maybe most of us don't use every day but believe it or not, I'm sure it's part of the way that we look at the world and we're gonna be contrasting it to, and this is kind of funny, we've been laughing about this either key-si-yan or key-ne-sian and I will spell it, K – E – Y – N – E – S – I – A – N economics and Kim, let's just kinda get you started there.

Kim: Absolutely. Well, in our laughter about pronunciation, I think it's pronounced ken-si-yan but none of us know, Siri doesn't know, Google didn't know, I won't say they didn't know but they gave us all kinds of different options, basically we gave up and said we're just gonna throw it out there and we wonder how you would pronounce the word K – E – Y – N – E – S – I – A – N. Now, don't shut off your iPod or listening device just because we're gonna talk about Austrian and Keynesian economics, it won't be boring we promise. We'll go through it quickly and it is interesting because there's definitely a lot of thought today that these 2 completely opposite methods of thought so it does not have anything to do with the locale, Austrian is a method of thought, it's not a place in this case. But these 2 completely different methods of thought and about how to run the economy and they're completely opposite and there are many people in the US government that have believed that one particular method of thought is the correct way to run the economy and then there are another group of presidents and cabinet members etcetera that run the government at different times in our country that believe the other way. And so it is relevant, we've got some economic issues coming up in our country and always will probably and there is 2 different schools of thought on how to handle them and that's what we're gonna talk about today are those 2 different schools.

Todd: Super. And in the current situation that we're in, the current government that we have, would you say that one is in more control than the other predominantly today?

Kim: Absolutely. So today's world is controlled by the current powers, if you will, that are in the United States government under the Keynesian economic theory and that is basically that the Keynesians think and the current people that run the US economy and I struggle even saying that because the idea that somebody can run an economy is problematic in my mind but the current president and cabinet members, etcetera think that they can and they run it under what's called ken-si-yan or key-ne-sian economics and it's based on what they believe is the spending being the motor of the economy, in other words, spending money is what drives things. They believe that the government should have central planning authority and they believe that because of that, the federal government should control the principles of banking, they should control the money supply and of course we've all seen evidence of this with the

Kiwi 123 and furthermore, the people that think from the Keynesian standpoint believe that deficit spending or borrowing to spend and putting our country more and more debt is what will drive our country forward. And I'm sure if we put a vote out to our listeners that we would get a certain percentage of you that believe the Keynesian theory of economics, we were all taught it in high school and college and even if we haven't ever thought about it since, it is something that people believe in and whether or not I believe in it right now isn't the point but it is an interesting issue to address and I think what's more interesting than is to take a look at the other school of thought but let's just make sure that we got Keynesian clear first Todd and I know you like the different pronunciation of it, would you add anything to that definition?

Todd: No, just for our main discussion here, if you wanna put a face on it, this, I guess the face on the Keynesian would be John Maynard Keynes, K – E – Y – N – E – S so thus maybe the pronunciation. And if we were to try to put a face or a spokesperson on Austrian economics, I think we probably would agree that it's Ludwig Van Mises, I believe I'm pronouncing that correctly.

Kim: That's my understanding as well.

Todd: So again, these were the 2 people who really, I wouldn't say that they invented it but they articulated these in to actually opposing theories and I'm in complete agreement that we have a central government now who's actively through the government trying to manipulate the economy to produce a better effect. Now, let's move over to the Austrian side and what's the theory there?

Kim: Well I thank you first of all for putting the name in the face to it, I agree it was necessarily invented by them but I think it helps people to have a spokesperson, a name or a face even though those gentlemen are now long gone and so we'll pull in a current face, if you will, and if you wanna talk about the presidential crowd, certainly Obama is in the Keynesian camp and the Paul family so Ron Paul, Ran Paul, etcetera, are more in the Austrian economics camp just to get a current face to it. And what Austrian economics thinkers believe is that saving is the motor of the economy, frugality, saving and the capability of the individual person to have dollars at their disposal drives the economy. Austrian believes that its private property not any type of government central planning, they believe that it's a free market economy that drives growth and that a sound money policy is held by returning the control to the private sector both individual banks and individuals, actual personal individuals. And it's interesting, when I look at these 2 things myself a while ago and really thought about it not from a political standpoint but from a monetary standpoint, the challenge with Austrian thinking as we know from our own personal lives is that when we save money, we temporarily remove that money from what is called the money supply. So think about it in your own family, if you put money in a savings account, you don't have that money to go out to eat with or go to the movies or go on a trip or buy clothes or whatever but long term, you're in a stronger economic or a stronger personal financial platform because you as a family have saved money. So the Austrian way of thinking is a fabulous long term solution but the Keynesian way of thinking is typically used as a short term solution and as we know, our government is playing kick the can these days where they just kick the problem down the road a little bit and they do that with social security, they do that with these 2 completely opposite economic theories and schools of thought. And for families, it's the same way, if we choose not to save money and we spend all of our money and we believe that we can actually use debt to build wealth which is a Keynesian thought process, we may be successful that but we also see families that because they don't have savings and because they have a lot of credit card debt, they end up in a position where they're financially very distraught or bankrupt or with extreme things happening like foreclosures, etcetera. And our government is no different except that they can tax so they can raise money, raise money, raise money whereas an individual family cannot always just go get a job or earn more money. And so the idea of the Keynesians is that they can grow with debt and we've seen families try to do that and a few have been successful, no doubt, there always are but meaning many failed because they have too much credit card debt and not enough savings. And the Austrians would say you can solve that problem by getting out of credit card debt and having savings. Well, let's apply that to our government and we could argue that today, our government has too much debt and not enough savings so that's where that Keynesian thinking is ruling their actions today.

Todd: Got it. And I think what impresses me the most when I look at this is that if we look at our current interest rate environment which is certainly a manipulated interest rate environment, because the rates are so low, there's an incentive to borrow and then an incentive to spend followed by an incentive to save because of dollars saved today will actually be worth less a year from now and not more so there's not a reward ratio in order to get people to save. Under an Austrian system, there would be higher interest rates that would kind of reverse that order, savings would become first which is how my grandfather lived his entire life, followed by spending and then a strategic use of debt so it's almost reversing the order of priority.

Kim: Absolutely, that's really well said and I'm grateful that both of us are able to take this really out their thought and drive it down to the personal level of our listeners and it is interesting when you have people say and they are often referencing their grandparent, oh, my grandparent said this and my grandparent said that and it is because much of the US government in the time that your, when our grandparents were living were Austrian thinkers even if they maybe didn't identified themselves that way, they were free market thinkers, they believed in little government control and lots of individual and personal control and that individual and personal control is beyond more than just how we control our money or whether or not we control our money. Clearly, if we look at people in today's society, in the past, they had more self-control than they do at least on the appearance side today. So it's control not only economically but personally as well.

Todd: I touched on the topic of inflation, discuss inflation under the 2 systems.

Kim: Absolutely. Well, inflation is causing the problem on the Keynesian side because it's dictating that dollars are worth less as we go forward and inflation is absolutely prevalent no matter what kind of economic thinking you have clearly. But inflation can be solved on the Austrian economic side by saving, especially when you can save in a place that will keep pace with inflation which is for the ???[0:11:49] time why we like using whole life insurance as a savings vehicle rather than savings accounts as a saving vehicle because typically, the growth on a whole life will keep pace with inflation which means that inflation is not undermining your capability and savings accounts, inflation is undermining your capability and that's a good example of those 2 different schools of thought as well.

Todd: Super. And you mentioned Ron Paul and I just happened to have a quote here from him, "The inflation tax while largely ignored hurts middle class and low income Americans the most. Simply put printing money to pay for federal spending dilutes the value of the dollar which causes higher prices for goods and services".

Kim: Absolutely. And while we know that there isn't technically a tax, we need to look at inflation like we look at taxes because whatever we can do to reduce the impact of it is important. And inflation affects absolutely everything that we do so a lot of times there isn't anything that we can do about it but having our dollars work as hard as possible. Having investments, so now I'm separating out the discussion from savings to investments, having investments that earn a good low double digit rate of return, 10% – 11% is necessary in order to beat inflation and especially when we then know that those investments are also taxed and there maybe fees associated as well and you must be able to get ahead even though there is inflation taxes and fees all pushing down on the money, you've got to be able to have, which is why the double digit is so important, you've got to be able to have an investment that helps you get ahead of that and we do couple of different ones. Some that just provide growth of value, some that provide actual cash flow at that double digit level.

Todd: Super. And the next section I just wanna touch on real quick is the role of a free market under the 2 systems.

Kim: Sure. So the Austrians believe that a free market economy is a healthy, effective economy and the Keynesians believe that the government should control the economy and again, I will try to put this forth without bringing in my own personal opinion on it but if we look at examples of government controlled economies like Cuba and like Russia, it's pretty evident that those long term were not effective. And when we look examples of free market economy like the United States, we can see that long term they're effective. So whether or not our current government believes whether the free market economy long term is effective, we can all guess that it does not but it is interesting when you look at for example a country like China because they have a little bit of a combination and their free market horse, if you will, is charging forward while their central planning government control horse has got the brakes on to the nth degree and it will be interesting to see how that plays out in that country but we do need to remember that the United States of America was formed on the basis of a free market and the desire for personal freedom which then comes with personal responsibility and goes back to that Austrian economic thought of you need to have personally controlled savings and personal responsibility for yourself and your money and if that's the way to get ahead whether the government dictating that you save money or forcing the savings for you like these new 401k plans where you sign on the dotted line as an employee and you're automatically signed up as your 401k whether you like it or not, that's the government forcing savings as opposed to us as an individual taking the responsibility and saying I'm gonna save myself.

Todd: Super. Well some additional resources that I would recommend to people who are listening to this, certainly go to partners4prosperity.com. We also have prosperitypeaks, that's P – E – A – K – S.com. Anything else you'd like to recommend there Kim?

Kim: Well, appreciate you bringing up both websites and just for clarity on them, Partner 4 Prosperity is our company site has information available to anybody, advisor, individual, etcetera about prosperity economics which is what we practice. And we talk in there about the difference between financial planning which you could almost say is a bit of a Keynesian approach and prosperity economics which you could almost say is a bit of an Austrian approach. And then on the Prosperity Peaks website, that's available to anybody, it's strictly education, it's not connected with a company at all and our real goal there is to get the prosperity economics movement out there and alive and helping people learn about the difference between typical financial planning and prosperity economics which we view as an improved environment to help people get the best use of their money possible.

Todd: Super. Also just real quick, I looked up, there's the Maynard Keynes, K – E – Y – N – E – S.org as well as Mises, M – I – S – E – S.org are also some additional resources for you. I just kinda wanna end with this quote and this is actually a quote from John Maynard Keynes, "The ideas of economist and political philosophers both when they are right and when they are wrong are more powerful than is commonly understood. Indeed the world is ruled by little elves. Practical men who believe themselves to be quite exempt from any intellectual influence are usually the slaves of some defunct economist." Any comments?

Kim: That's fabulous. Well thank you for finding those additional websites, I think that will be helpful for people that wanna learn a little bit more about this. And learning is the name of the game, we've got to be educated about these things even if only at a brief level so that when comments are made by those in political and even media environments, we will turn our brains on and we know that the first principle of prosperity is to think. We need to turn our brains on, get clear on whether or not we agree or disagree with the statement being made. And both quotes that you've found from both side of this issue are fabulous, thanks for grabbing those Todd.

Todd: Super. This is No BS Money Guy for The Prosperity Podcast, take care everybody.

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