

A HOUSEHOLD UNDERSTANDING OF THE ECONOMIC CRISIS

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Despite the “gloom and doom” pronouncement that many commentators are making regarding our current economic situation, the formula for solving our nation’s economic woes is actually very simple. In fact, most average Americans already know the formula—in both a general sense and in detail. The problem is that the majority of Americans who know the solution don’t know that they know the solution.

One of the grandest deceptions in government and economics is the lie that a nation’s economy operates under different economic laws than does a household, church, or business. This is the fallacy of the British economist, John Maynard Keynes. Keynes was an adversary of free market economics, and he believed that governments and central banks must use their control over money and spending to counter the business cycle. This idea is just one of the many flaws in Keynesian thinking. We could discuss a number of other problems, but let’s focus on one of the most fundamental: Keynes’s misunderstanding of macro-economics.

Let’s start by establishing some economic principles that are specific to a household. If our household encounters difficult economic times, what should we do? Whether the economic difficulty stems from a loss of income or an unexpected expense, we intuitively know what we need to do: reduce our spending and attempt to increase our income.

Who in their right mind would advise a family to solve an economic crisis by borrowing and spending more money? Although we could stimulate the family’s economy in the short run by using the credit card to buy food, clothing, or even a new TV, everyone knows that this does not get to the root of the problem—in fact, the increased debt that would be incurred by this strategy is counterproductive in the long term. The result of a borrowing and spending binge would be the ultimate worsening of the family’s economic plight. This principle is also true for the subcomponents of the family.

We cannot make the family richer by having the wife borrow money to give to her husband. Shifting assets and liabilities between family members does not change the family’s net worth.

These principles for dealing with economic distress are based on economic laws, and they apply equally to the household, the small business, the church, or the big business. If the principles apply to all of these entities, why don’t they apply to an entire nation—or its government? The answer is that they do, in fact, apply to both nations and governments. The laws of economics don’t change based on the size of the enterprise. Unfortunately, our government’s current policies are based on the opposite assumption. It seems that Keynes viewed the government as totally external to the nation’s economy, but nothing could be further from the truth. A government draws its resources from its citizens, who are all within the nation’s economy.

Economists make a distinction between two kinds of economic study: macro-economics and micro-economics. The study of micro-economics is the study of a single enterprise, whereas the study of an entire economy is called macro-economics. Some schools of economic thought teach that macro-economics is exempt from micro-economic principles. But this is patently absurd, since the economy of a nation is nothing more than the amalgamation of all of the individual economies of which it is composed. Our nation’s economy can only improve if a majority of its household economies improve. We cannot make our families better off by increasing their debt... and government cannot borrow on behalf of the general economy without imposing debt on the families that it represents. Yes, the borrowing and spending of a government can give the temporary appearance of well-being (just like the borrowing and spending of a financially stressed family), but the ultimate consequence of such policies is to increase our poverty.

The majority of Americans who know the solution don’t know that they know the solution.

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Some would argue that a macro-economy holds a unique ability to stimulate itself into prosperity. By stimulating demand for goods and services through government borrowing and spending, the Keynesian economist argues, the enterprises receiving the stimulus dollars will begin a chain reaction of spending that will increase employment and economic well-being nationwide. Although we don't have the space here to deal with all of the economic analysis of this position, we can easily test the primary component of this logic. If this reasoning is valid, it would seem that a group of households or a group of businesses could do the same thing with the same result. They could each borrow significant sums of money and then use this money to buy goods and services from each other. The resulting increase in demand would produce wealth among this group sufficient to pay off the debt and still be ahead of where they were previously.

Of course, if this actually worked, families, churches, and businesses would make this a regular practice. Unfortunately, this “borrow, spend, and stimulate” formula is unlikely to produce real wealth. Instead, it artificially increases demand for goods and services that would not have been purchased otherwise. This artificially biases spending decisions and causes producers to misallocate their capital resources. It also leaves the participants with more debt than when they started. The interest on this debt will eventually lower the standard of living for most, if not all, of the participants.

Every American president since Herbert Hoover, both Republican and Democrat, has operated from a Keynesian perspective. It is high time that we return to the basic understanding that the fundamental laws of economics apply to all enterprises, big and small. The solution for a nation is no different than the solution for a household: reduce debt, save, and produce. That is the formula for a prosperous America.

There is only one way for a family to have real economic improvement without thrift or productivity, and this is to receive a windfall from outside the family. Such a windfall might come from winning the lottery or the death of a rich uncle.

Some would argue that government actions are just this kind of external rich uncle, but the government has no wealth of its own—it has only the wealth of its citizens. Our government cannot inject any real resources into our economy that it does not first remove from the economy in the form of taxes or inflation. In this regard, Uncle Sam is not the kind of uncle who can aid our household by giving us some of his wealth. Our Uncle Sam is us—and anything he gives he must also take.

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