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Guest: Jonathan Newman

WOODS: All right, so I know where you teach, but they don't. So where do you teach?

NEWMAN: I teach at Bryan College which is in Dayton, Tennessee, just north of Chattanooga. It's a small, private, Christian liberal arts college in Tennessee.

WOODS: Is it drivable to here? Did you drive?

NEWMAN: Yeah, it was about four hours driving.

WOODS: Oh, it's nothing at all. Okay.

NEWMAN: You do have to go through Atlanta, which it's getting more and more dangerous to travel through Atlanta these days.

WOODS: Ah, okay. Now, you look like a pretty young guy to me. Can I ask?

NEWMAN: Yeah, yeah, yeah, I'm 32.

WOODS: Gosh. I mean, I suppose biologically I could be your father, just not very likely. We'll just put it that way, would not be very likely. All right, so you're a youngish guy. How long have you been teaching?

NEWMAN: See, I started teaching at Auburn. I was a graduate teaching assistant. I think that was in 2012, they put me in the classroom by myself. And so ever since then, so it's eight years now.

WOODS: Geez, man, you were teaching when you were about a pup.

NEWMAN: Yeah, it was actually really good that they put the graduate students in the classroom, because it allowed them to develop a lot of teaching skills really early on in the program.

WOODS: Yeah, yeah. Yeah, I didn't do much of that when I was in grad school, because I wasn't really going out of my way to get positions as a teaching assistant, because I was doing I had other jobs. I was working for a magazine, and that was paying the bills much better. And also, I thought, I'm in history. I mean, what skills does it take to teach history? It's not like people are sitting in the audience, like, I don't get it. Was is there to get? This war happened.

NEWMAN: [laughing] Sure.

WOODS: Whereas with math or economics, it requires detailed explanation. You have to learn how to explain things in ways that aren't confusing for the general public. So I didn't think it really mattered. And then I went on the job market and they all wanted to know what my teaching experience had been. I thought, but I worked on this magazine. Doesn't that matter? Isn't that impressive? So you obviously definitely did it the right way. So is this one of these colleges with a heavy teaching load?

NEWMAN: Oh, yeah, it's a four-four teaching load, and I usually take on some extra classes in the summer, but that's what I prefer. I prefer emphasizing teaching over research. I still try to do some research and some writing when the time permits, but I really thrive in the classroom. My favorite part about teaching is the aha moment that you get from a student, where they've been explained something many times before by somebody else, and then you figure out the way to express that idea in some way that just clicks.

WOODS: Right. Right, right. Yeah, yeah, I love that. That's a very satisfying — that gives me the kind of feeling that a comedian gets when he gets a big round of laughter, that you hit just that spot and it worked out. So just for the sake of the audience who may not know the academic lingo, four-four means you teach four courses in the fall and four courses in the spring. So at a big research institution, what you'd be shooting for is two-two, or if you're the department chairman, it might be two-one or even one-one, which is ridiculous when you think about it.

NEWMAN: Right. Yeah, yeah. There are lots of professors in very cushy positions. And of course, if you take on administrative duties, then you get an even softer load sometime, and so they get an even further break from the classroom.

WOODS: Are you guys doing in-person instruction this fall?

NEWMAN: We're aiming for it. Everything that I've heard from the administration is that they're going to go for it, in-person instruction with smaller class sizes, and they've changed the schedule up a little bit. But that's the plan.

WOODS: Okay, all right, that's good. So, now that we're going to transition into some economics, what would be the typical four courses that you'd be teaching at any one time?

NEWMAN: Well, I'm a professor of economics and finance, so I also teach some finance classes in the business program at Bryan. But the econ courses that I teach typically are principles of micro, principles of macro. I like to do money and banking when I get a chance, and other electives like history of economic thought.

WOODS: Okay, what's your absolute favorite thing to teach?

NEWMAN: I really like principles of macro, because I like showing the history of thought of macro and comparing the different frameworks that we've discussed here at Mises U this week, like putting the Keynesian model up against the Austrian model and up against the monetarist way of doing things, and students like to — I try to turn it into a debate somewhat, so the students can try to figure out which framework does a better job of explaining the economy.

WOODS: Okay, so this year, you gave a lecture on business cycle theory, Austrian business cycle theory, which is a lecture that's been given for years, up to last year at least, by the eminent Roger Garrison, who's retired now from Auburn, who wrote *Time and Money*, which is a treatise on Austrian capital theory. And he's been known for his notorious PowerPoint presentation on Austrian business cycle theory.

NEWMAN: Oh, yeah, beautiful.

WOODS: Yeah, I mean, even complete with sound effects and everything. And I absolutely love that guy. I could never get him to come on the podcast. Every time it would turn to that, somehow he changed the subject and whatever. But he's a really, really smart and gracious and good guy. So you had some big shoes to fill.

NEWMAN: Yes, I think it was 2009 was my first Mises University, and it was Roger Garrison's lecture on Austrian business cycle theory that was sort of my aha moment. I was an econ major in my undergraduate program, but when I came here in 2009 and I saw this lecture by Roger Garrison, I saw the moving graphs and the hilarious jokes in there, it was just beautiful to me. And that's where I decided, I'm going to come to Auburn and study economics. This is what I want to do with the rest of my life. And so this week has been sort of like a complete circle for me to finally have the chance to give this talk that inspired me to study economics.

WOODS: Yeah, that was amazing. Did you ever tell him that?

NEWMAN: I can't remember.

WOODS: It's the sort of thing that somebody in the educational profession wants to know, right, that he did that for you.

NEWMAN: Yeah, right. I took his principles of macro class at Auburn, and I was the annoying students that would always bug him after class and like want to walk with him back to his office and ask him questions and all that sort of things. I was the Roger Garrison fanboy at Auburn. I also took history of economic thought from him. It was just a pleasure to learn from him.

WOODS: Yeah, yeah, I bet, I bet. Okay, all right, so now, it's true — we were talking about this beforehand. It's true that we've talked about the Austrian theory of the business cycle before, but it's been a while, and people could either use a refresher, or for some new listeners they could stand to know it, because I really think understanding the business cycle is some of the most important economic knowledge people can have, especially in an age when central banks are more and more unmoored from what even the textbooks teach about what central banks ideally ought to be doing according to their own principles.

So I do want to talk about that and make sure at the beginning that everybody understands when we say "Austrian," we're talking about a school of thought within economics, so named because its early theorists came from Austria. So we're talking about the school of thought that includes Mises and Hayek and Rothbard, and then earlier on Menger and Böhm-Bawerk and so on. So that is the tradition of thought that is being taught and preserved and built upon here at the Mises University program, which is the program that makes it basically turned me into a member of the Austrian school all the way back in 1993. This has been going on for a long time, deserves your support, as does everything the Mises Institute does. So how do you, when you have to explain to the general public what the Austrian business cycle theory says and you don't have all day to explain it, what's your kind of elevator pitch for it?

NEWMAN: Probably the easiest way to grasp it is to contrast the boom-bust cycle with sustainable economic growth. So sustainable economic growth can only happen by setting aside resources for production. We have to save first, and that that's what allows entrepreneurs to take those saved resources and expand production. And it's all sustainable, and entrepreneurs are correctly responding to what consumers are doing in terms of saving and consuming. So we contrast that sort of framework, that way of thinking about economic growth with the boom-bust cycle, in which entrepreneurs are sort of tricked. It looks like there are saved resources, but there actually aren't. And the trick or the disguise comes from credit markets, where the central bank or the fractional reserve banking system has increased the supply of loanable funds, the interest rate is pushed below the normal rate, and so entrepreneurs expand production in such a way that isn't in accord with what consumers have actually said, and that's why it's unsustainable. Was that short enough?

WOODS: No, that was pretty good. That's a very Garrisonian approach, because I remember in his presentation, he said — and I think here, he might have been appealing to Hayek when he said that in order to understand why things go wrong, we first have to understand why they could ever go right.

NEWMAN: Yeah, that's a Hayek quote.

WOODS: Yeah. And so to understand the role that the rate of interest plays is key to understanding what breaks down, because when the rate of interest is allowed to perform its function, it is in effect alerting entrepreneurs to certain things. It tells them something about people's preferences, and not just what they want to consume, but *when* they want to consume.

NEWMAN: Right.

WOODS: And so getting this time dimension right is very important, because it influences not just the amount, but the kind of investments they make. Now, you can tell me if you think this analogy works, but I've tried to get people to see the role that lowering interest rates can play by having them think about their own 30-year mortgages. Because when you have, let's say, a one-year mortgage, well, most of those payments are going to be principal. The interest rate is not going to play a huge role there. But if that loan is extended for 30 years, you know because you've looked at the your statements, that the first years of paying that mortgage, it's almost all interest. It's painful to see how little progress you're making against that giant loan.

NEWMAN: Extremely painful, yeah.

WOODS: And so when you're dealing with a 30-year payment and the interest rate comes down even slightly, it can make a very significant impact on your life. And so likewise, when interest rates are sort of artificially pushed down, artificially or real, it makes entrepreneurs think, well, now I can more afford that longer-term project. I can afford to finance that longer-term project. So it makes them do different kinds of things, not just more of the same thing.

NEWMAN: Right. And I talked about business cycle theory with Professor Salerno, who's in charge of Mises U here, and he actually tries to de-emphasize or take the focus off the interest rate as a number by itself, because somebody could respond and they could say: well, why don't just you know entrepreneurs wised up to this? Why don't they just realize, oh, interest rates don't always reflect consumer time preferences? And so Salerno talks about the income effect, that the actual availability of funds is there for entrepreneurs to take, and that availability of funds does not reflect additional saved resources. So it's not just the interest rate; it's also just the sheer availability of brand-new green slips of paper that didn't exist before.

WOODS: Right. Right, right. In fact, I think this may have come from a lunchtime conversation I had with Joe years ago, where he was trying to put flesh and blood onto the theory to make it more understandable. And he was saying, let's think about a situation where things go right. And let's say people save more, and as a result, interest rates come down.

So when they save more, two things come from this. Number one, saving more means I'm not blowing my entire paycheck in the present immediately. I'm deferring some purchases for the future. Well, that is the moment for entrepreneurs to plan for the future, to invest for the future. So there's a coordination there. But secondly, the fact that I'm saving means that resources that might be used to cater to immediate consumption are now released to be available for longer-term investments. So trucking services that would have shipped consumer goods, maybe they're available to ship machine tool parts or something at a higher level of production. So in other words, there's no tug of war with longer-term investment and shorter-term projects having a tug of war over the same resources. Tithe resources naturally flow from one stage of production to the other, because they're not as needed for immediate consumer use.

Whereas when things go wrong — and let's say by things going wrong, I mean you have artificial intervention. You have the Federal Reserve or the fractional reserve banks artificially pushing interest rates low. Well, in that case, I'm not necessarily deferring my purchases, so the entrepreneurs are going to get the wrong idea. And then secondly now, because I'm not deferring my purchases, you have all these resources that are still dedicated to consumers. And now you've got all this long-term investment going on. They need the resources too, so they're having bidding wars over them. It's discoordination. Is there anything wrong with the way I described that? Because I hope not, because that's how I've been explaining it to people.

NEWMAN: Oh, no, that's exactly right. So what you've just described, i's the two key features of Austrian business cycle theory, or at least the two key features of the boom, which is malinvestment — so entrepreneurs start creating the wrong sorts of capital goods and investing in the wrong lines of production — and also overconsumption, which is probably what you emphasized most in that. So the overconsumption happens when consumers respond to artificially low interest rates and the increased availability of loans to expand their own consumption. So it's not just the fact that consumers didn't say they want longer-term projects or they want consumer goods in the more distant future; it's that they've actually increased their consumption. So we actually have a deterioration of the capital structure.

The capital structure, by the way, we see in this discussion why the capital structure is so important for the Austrian business cycle theory, because you don't have that in the mainstream. You don't have this view of production taking time and capital being allocated in specific ways so that we get consumption goods at specific times. The mainstream view is just like one big letter K or one big aggregate K, and you miss out on all of that sort of interplay.

WOODS: I've talked to a number of different people who are in one way or another influenced by Austrian economics as investors. Now, that's a different kettle of fish entirely. I mean, having a feel for that world is not necessarily something that you get just from studying economics, pure economics. But I've had a guest on, maybe I won't mention his name just because I don't want to complicate it with personalities, but who says that he understands and appreciates and respects the Austrian theory of the business cycle, but he says he thinks it makes Austrians unnecessarily bearish for too much of the time. Because the central bank is always up to some shenanigans, and so he thinks that a lot of profit opportunities are missed by Austrian-informed investors, because they're always waiting for the big crash to come. But there are a lot of great opportunities to be had in the immediate run. So do you, as a pure economics professor, have any instincts about that?

NEWMAN: Oh, that's true to an extent. In fact, I've seen a few investment newsletters where the author is informed about Austrian business cycle theory, and the goal is the timing. So there are profits to be had during the boom phase of the business cycle. If you understand Austrian business cycle theory, you might be wary, you might be a little bit more cautious than other people, but that doesn't negate the fact that you can earn a profit during the boom phase. The trick, however, and it's actually something that economic theory can provide, is timing. It's knowing exactly when the crash is going to happen.

WOODS: Yeah, and then also there's the question of, obviously, not everything gets wiped out in the in the bust. Some things will not only survive, but thrive. And the question is: is there a way to get a handle on what those things will be?

NEWMAN: Yeah, it takes a lot of skill, I guess, to be able to have that sort of foresight. It's not something that I would say that I'm specialized in saying or foreseeing. But you're right, so it's not like a total loss. When we have the bust, there are certain capital goods, certain industries that are affected more than others. And in fact, there are certain counter cyclical investment assets and counter cyclical industries where, if you're informed about Austrian business cycle theory and you realize that there's a bust coming, then you might start putting some of your money in those sorts of investments to prepare.

WOODS: Well, and then too, maybe one example of that type of product if we're thinking on the same wavelength, was mentioned here at Mises you earlier this week, namely Spam, the Hormel company. Because Spam is a very big recession-style meat, because it's inexpensive and it's got a lot — it has things to be said for it. I've never so much as considered eating it. And then also, because each of these cycles, you see commonalities. You see this skeleton of the Austrian business cycle theory present in all of them, but there's always some unique characteristic, it seems to be. So obviously with 2008, we had housing, and the decade before that we had the dotcom thing. And so the way Roger Garrison used to put it is that whatever the big thing is at the time — so maybe in the '20s, communications of some sort — whatever the big thing is, will be kind of deformed and blown out of proportion during the artificial boom.

NEWMAN: Yeah, the way the boom and the bust actually plays out depends on sort of the vagaries of history, what sort of things are people interested in. Probably most importantly is where is the government involved. So in the lead-up to the housing bubble, we saw the federal government was encouraging lots and lots of homeownership.

WOODS: Yeah.

NEWMAN: And so we can speculate what sort of things might be a bubble right now. And probably the best place to look would be what sort of thing is the federal government encouraging a lot of. Some people might mention getting a new car, so there was the Cash for Clunkers program, but we've seen auto loans have increased. Also student loans, there's been lots and lots of federal government encouragement for people to borrow lots of money to go to college.

WOODS: Yeah, yeah. Yeah, so we definitely have those things. So how does knowledge of the — see, to me, knowledge of Austrian business cycle theory is important because it's just good to know how the world works rather than not to know. But it's also important for us to defend ourselves against accusations against the free market, that, *Oh, it just goes to show we leave you people to your own devices and look what happens. We get this boom bust cycle.*

NEWMAN: Yeah, so a lot of people, they pin the boom-bust cycle and financial crises on capitalism or the free market. So this thing is so unstable, obviously, we have 100% pure free market now, and so anything bad that happens is capitalism's fault. But Austrian business cycle theory, it's very logical, and it shows that no, there's nothing inherent in the unhampered market economy per se that would give rise to a boom-bust cycle or financial crises. Same with the different sorts of banking systems, full reserve banking versus fractional reserve banking.

WOODS: There's an article that somebody who normally teaches here, Lucas Englehart from Kent State, wrote trying to answer one of the objections to business cycle theory that you hit on earlier, which was that: why don't entrepreneurs get wise to this? If the Federal Reserve is artificially lowering interest rates, why don't they realize, okay, wait a minute, I'd better be careful here? I'd better tread really carefully and not be reckless. And there have been numerous replies to this, and apparently Joe has his own kind of reply, but I can think of — well, there’s one that's like a prisoner's dilemma thing, where there's an argument that if everybody else is expanding during the boom and I don't, then I'm going to suffer relatively to them, so I better jump into it even if it's against my better judgment. But what Lucas said in his article was something like, it's not that entrepreneurs become fools; it's that fools become entrepreneurs during this time. What do you think about that?

NEWMAN: Yeah, that makes sense to me. So what the artificially low interest rates do and what the expanded availability of loans does is that not only do the existing set of entrepreneurs now have new projects that they can undertake, but it also gets those marginal entrepreneurs that might not be as good as their fellow entrepreneurs, it gets those people to come in and participate in the boom production.

WOODS: Exactly. There's more credit available, and given that at any one time — now, you're the banking expert, but it seems to me that at any one time, a bank, to make as much profit as possible, is lent out to the extent that it can find creditworthy borrowers. So in other words, if there's an additional injection of credit, by definition, any additional loans therefore are going to borrowers who were not of the original standard.

NEWMAN: Yeah, so that logic applies on the consumption borrowing side, of consumers who are borrowing, but also producers. Same exact logic.

WOODS: Yeah. Yeah, yeah. Is there anything on this subject that you've written that's not behind a paywall?

NEWMAN: Oh, I've written about Austrian business cycle theory for Mises.org a few times, so if somebody just searches for my name on the Mises —

WOODS: Oh, I'll find it. I'll put them on the show notes page. TomWoods.com/1695 is where we'll have some stuff on this. Do you think there are any weaknesses in it? Is there any part of it that you wish we could shore up better?

NEWMAN: Well, I think that there has been some unprecedented changes in central bank policy very recently, not just since the last financial — or I shouldn't say that anymore — the 2008-2009 recession and financial crisis. But also just in the past few months, there have been some pretty significant changes in the way the central bank does monetary policy. And I think that there's some room in the literature for us to make sure that what the central bank is doing is taken into account in Austrian business cycle theory.

One good example of this is the central bank has started paying interest on excess reserves, which is a brand-new policy that they didn't have before. And one effect of that is that new money, new bank reserves that enters the economy doesn't necessarily leave the banking system. It doesn't necessarily come out and turn into malinvestment and overconsumption, and so that's something that we should take into account. Joe Salerno has a great paper called "A Reformulation of Austrian Business Cycle Theory," in which he's taken into account some of these sorts of things.

WOODS: Yeah, you know what? I'm going to also link to that paper.

NEWMAN: It's a great read.

WOODS: Do you know, has that been published, or is it a working paper?

NEWMAN: Yes, it's published.

WOODS: All right, I'll find it. I'll put it at TomWoods.com/1695. Do you have a website of your own or a faculty page at Bryan?

NEWMAN: Yeah, I have a faculty page at Bryan College, but in terms of if people are looking for things that I've written, the best place to go would be Mises.org.

WOODS: Okay, all right, I'll put your article archive up at TomWoods.com/1695. All right, now we're going to resume the program, so thanks for your time, Jonathan. I appreciate it.

NEWMAN: Well, thank you for having me.