Episode 747: Media and Public Confused: Who Creates Jobs, Consumers or Entrepreneurs?

Guest: David Howden

WOODS: In yesterday's episode I talked to Jeff Herbener. You're spending some time at Grove City College this semester, and I talked you up on the air as on of the — when I first met you we had dinner at this Cuban place that no longer exists in Auburn, and I remember just that dinner I was thinking this is one of the up-and-coming guys. And I said you've done nothing to change that impression in my mind. Now, maybe this appearance on the show it'll go down the toilet, but up to now —

HOWDEN: [Inaudible]

WOODS: (laughing) Yeah. So now you've got a lot to live up to. Anyway, I want to have you on because somebody sent me the following statement, and it's the sort of statement people hear all the time. And I thought, I think it would be nice for us to address this because it's repeated so often. And it was in a discussion about the minimum wage, and somehow this discussion got diverted into a question of why tax cuts for upper income people don't do any good. Here's what the person said:

"Tax cuts for big business and the rich just wind up in Ireland or the Cayman Islands. However, if we put that money into the pockets of workers, they will spend it, and that will increase demand for goods and services. To meet that demand, businesses will have to hire, creating more jobs and prosperity. This is why the middle class and not the rich are the true job creators in the economy."

Now, I think there's a lot of confusion in that statement, but I think it's also difficult for a lot of people to put their finger on exactly what's wrong with it. There are a few different ways we can attack it, or a few different points that are implicitly made in there, so we could start with the taxes issue itself, but I'd rather start with the more fundamental question of why isn't it the case that really the people who are driving the economy are indeed the consumers? Are the workers who have a higher propensity to consume, let's say — why isn't that a good thing? Because after all, I'm a merchant I want people coming into my store and spending money. I don't need — it doesn't help me if some rich person earns his money and then sends it to the Cayman Islands. The worker who comes in and buys a new shirt benefits me.

HOWDEN: Yeah, do you know, Tom, the second part of that paragraph that you just read there, it gets back to the age old question of what actually drives prosperity. And you can either focus on entrepreneurs and smart businessmen going out there and correctly estimating what it is that consumers want to buy and giving them the best product possible, really satisfying their needs, or you can take the view that consumers just coming in a store and drumming up business and revenues, that that's going to create prosperity.

And when I think about it, I think it's a little bit — well, it's more than a little bit — disingenuous towards entrepreneurs, because it treats them as just passive observers in this whole process. For example, the idea that you would just have a store out there, and if we give consumers more money, of course they're going to go into your store, as this type of logic has it, spend that money, that's going to create revenue for you, you will respond by expanding your business and hiring new people, and the process continues. The entrepreneur there, they're not really doing anything active; it was just the person who owned the store, and it's the consumers who are walking into them and buying their products, almost like the process is blind. The thinking behind it makes no reference to the quality of the business or the hard work that the entrepreneur has gone into previously to attract those customers into their store.

And instead, I think you need to change the emphasis a little bit and focus on the business owner, the entrepreneur, and actually ask, well, why would somebody actually come into their store. Consumers, you know as well as I do, we don't just go shopping blindly if we have money, and we got a tax cut so that we stumbled into extra money, even more so we would use it wisely. We wouldn't just go out and go into the first store that came along; we'd do the normal appraisal process of finding the stores that best suit our needs, that have the goods, the services that we actually want to buy, and then giving those businesses our money.

And the question — I guess for me it really comes down to who in this process do you really want to reward. If you want to consider a tax cut as being a reward — you know, it's just letting you keep more of your money that was already yours to begin with. But all that aside, if you want to treat the tax cut as a reward, shouldn't we be rewarding the entrepreneurs that are really smart and hardworking and going out of their way to really serve customers, instead of the customers who are taking advantage — I'm using that maybe a little bit more strongly than I mean it, but they're going out there and they're taking advantage in a good way of the entrepreneurs that have put so much hard work into it and have offered them such great services that they're willing spend their money with them.

WOODS: I see where you're coming from with that, but I still feel like the person would say that's a lot of nice talk and yeah, of course it's important to recognize the role of the business owner, but still, how can the business owner prosper unless the ordinary Joe who's actually willing to spend his money, as opposed to either just sitting on it or exporting it out of the country — unless that working Joe comes in an spends his money, your vaunted business owner ain't nothing.

HOWDEN: That's definitely true, but that's a different question. The question is should we be giving consumers more money, and then what are they going to be doing with it. And the person who gave you that statement that you had at the beginning, it's almost as if they think that the consumer is just blindly going to go into stores and spend their money on anything, instead of saying, no, what is it in particular that would drive a consumer into this store or that store to give that business owner their money. And of course if you view the problem through that way, you'd have to recognize that the business owner himself has to go through a lot of work to try to serve the customer the best, to make sure that that stream of money spending goes into his store and not someone else's.

WOODS: But isn't it the stream of money spending that creates the jobs? That's the argument being made here, that the job creators are really the ordinary guy who comes in and buys the shirt. So the question is, do sales revenues, is that where wages come from? Is that where all this stuff comes from, or is that coming from entrepreneurial saving? Where does it come from?

HOWDEN: If you wanted to look at it on that level, you could take a very micro example, so to speak, of a person who spends money on food and clothing and vacation and entertainment and things like that, basic consumption expenditures, and doesn't save much money, versus somebody who is thrifty, who isn't buying a new car every year, who doesn't take that many vacations, who saves a lot of money. And then just compare those two people. Who is the more economically prosperous? And in the short period of time, you might say, well, the person who is consuming a lot, spending a lot of money right now and saving little, appears to be more successful, but it's only in appearance. Over time we will see that the person who saves more, invests more, is able to become more prosperous, is able to see his income grow over time. His investments will give him a return.

And so if we extrapolate from this, we can see that it's not the actual spending on consumption goods that is driving the economy and creating prosperity; it's actually people saving money. And the channel of that is hard to see, because again, for most consumers they don't actually see what happens with their savings. They put it into stocks or bonds, but they don't actually personally see where the fruits of their savings actually go to. But of course that's where the entrepreneurs come in. The people who borrow those savings and expand their businesses and create new products that didn't exist before and do research into what it is that consumers want, that's really what's driving the economy and creating prosperity, but it's necessary that people save money in order to fund these types of activities.

And so this person — and this isn't completely unusual. Many people make this confusion. This person thinks that it's the actual spending on consumption goods that's creating prosperity, and he's ignoring completely the fact that, no, the savings that you're not spending today, somebody is spending them, except they're being spent on business development and expansion behind the scenes, and that's really what's growing the economy and creating prosperity.

WOODS: All right, great. So why is that the source of prosperity? What's so special about that?

HOWDEN: Well, let's say that you were just a car company and you had a new production process to form the steel on your cars, the bodies. The only problem is you don't have funding in order to pursue the research and development necessary for this, and even once that's complete you don't necessarily have the funding within your own company to open up a new factory in order to produce the bodies with this new type of technology. And so you need to borrow money from somebody else. You need savings that somebody else has accumulated and that they're willing to lend to you so that you can do this research and build this new factory.

And in borrowing that money from somebody else, you're going to, sure, remunerate that person by giving them a dividend or an interest payment. That's what consumers see from their savings. That's the only part they see really, is the return on their investment. But behind the scenes what they don't normally see is the businessperson who has borrowed that money builds a new factory, and that factory employs people, and those people then have income to spend on goods and services. And this is the process of prosperity: new people being employed in new types of production processes that didn't exist before, or maybe processes that existed before but now they're improved upon. This is what's really driving prosperity.

It's not that, oh, I used to buy three new shirts a year, except now I'm going to buy four new shirts a year, and so sure, there's a store that's going to be making money in excess of what they made last year because I'll go in an buy an extra shirt. That's relatively small potatoes. That's like a one-time shot in the arm, so to speak, that that store gets. With the savings process I'm going to fund an investment that will then create a whole new line of business, which will employ other people and so on and so on. So it's this savings going into new business development that's driving prosperity, not just this expenditure on consumer goods that, by the way, have a lifespan on them. I mean, a shirt only lasts you so many years, but your business investment keeps feeding into itself over time.

WOODS: What about this image people have, though, of the rich as being people who just frivolously dissipate their money on ludicrous expenditures and that these are not people who by and large expanding business capabilities and so on? They're just people who enjoy leisure time, and they enjoy conspicuous consumption. I mean, that's the way people look at it, and that's part of the reason I think they have trouble seeing that there might be some social value to things that rich people do.

HOWDEN: Of course, because it's not sexy to show what business people actually do, the hard work that they put into it. Instead we have *People* magazine and the news who want to focus on these very attractive, frivolous lifestyles that some rich people — far from all of them, by the way — but some rich people do pursue. But of course, in order to fund such a lifestyle you must be doing something to earn income to support it, and that's the part that nobody ever sees. Like, nobody sees the business owner who's working seven days a week, the small business owner who's working all weekend long, or evenings, or is home late for dinner with the family. Nobody sees this, and I don't think anybody particularly wants to see this, because it's not exactly the happy part of the whole image. The hard work is the essential art, but people would rather focus on the fruits of that labor. And so of course all we see, if we do see wealthy people, it's frivolously spending their money on vacations and lavish clothes and things like that. And again, that's far from everybody. That's only a very small proportion of people who are doing such things. But of course we never really see what had to happen previous to these lavish vacations so that they could be funded, and that's the hard work that the entrepreneurs are really putting in.

WOODS: All right, let's pursue this a bit further after we thank our sponsor.

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All right, let's go back to that original quotation, because in there there's also an attempt to deal with what we might call leakage from the economy, because people would say, how does it possibly benefit the US for some rich person not to be taxed. If the rich person were taxed we could take his money and spend it on stuff here, but instead, even Dave Howden would concede there are some businessmen who take their money and they park it offshore somewhere. How does that benefit us? Whereas if we were able to take — now, leaving morality out of it, if we were able to take that money we could build a bridge with it? Or at least we could put it in the pocket of a worker who could go and buy shirts at a store and help that store. How does some guy leaking money out of the economy do us any good?

HOWDEN: Well, do you know, on the one hand, this whole claim that we'll give tax cuts to wealthy people and these wealthy people are just going to take this extra money that they have and go to Ireland or Cayman Islands or some other incidentally low-tax regime, it seems a little bit strange that we're worried that cutting taxes will cause money to leave our country, and at the same time the countries who we think will be the recipients just happen to be low-tax countries as well.

WOODS: (laughing) Yeah, that's a good point.

HOWDEN: Just for example, the corporate tax rate in the states, the OECD did a little study — they always do a study on this every year, and it's among the highest countries in the developed world. It's about 35% on average right now in the US, which is quite high compared to, say, Ireland, which is in the low teens. And so of course it would make sense that if you did have extra money to invest, maybe you would want to go pursue business development over in Ireland since the tax rate is almost a third what it is in the States. But at the same time, you'd have to say, well, it must be that having low tax in Ireland is such a great thing because it's attracting all these businesses to go over there and invest. And you can't really have it both ways. So that's the first big problem I have with this statement, that you can't say low taxes are bad for our country because they'll drive money out of it as people take these extra saving out, but at the same time they're going to put it into countries that have low taxes.

The second thing, and I think this is much more important because it's the part of the statement that I don't think most people think about, and this person I don't think has thought about, is to answer the question: why would money leave your country in the first place? Like, if we give tax cuts to an American, why would that American decide to take that money out of the States and put it into a foreign country? What's driving people to take their savings out of this country and put it somewhere else? And of course if you really think about it, then you'd have to say, well, what's — you know, if you really want to do soul searching — what's wrong with the United States? What's wrong with this country? Why is it that we would do something nice, like give somebody a tax cut, and they would repay us by getting their money out of the country? And that doesn't make too much sense, unless they were worried about business conditions in this country or unless it's difficult to do business in this country. Regulations are all over the place and not getting any lower or less complex. Taxes, again, I've already said they're relatively high on businesses in the US and lower overseas.

So we really need to do some soul searching and say what is it that would cause somebody to get their money out of this country, and what could we do in order to keep that money in this country. And if you answer that question by saying, well, we could keep the money in the country by just raising taxes because then you would be forced to leave it in the country — it would go to the government, and that stays here — that's a pretty terrible way to answer the question, I think, instead of going to the root problem of why is it that people voluntarily would want to get their money out of the country.

WOODS: Right, yeah, that's what I wanted to ask about, and that is not really explored in this quotation, and I think it's partly because there's an assumption that wealthy people don't really have any rights. They're lucky we let them keep what we let them keep, but there's never any sense that they might have any legitimate interests of their own. They're just terrible people who are hiding our money from us, is the way they look at it. They don't pause and ask themselves why would somebody want to do this in the first place.

HOWDEN: Do you know, I am always glad that I am not a wealthy person — monetarily wealthy. I'm wealthy in many other ways.

WOODS: Indeed, indeed. You're wealthy in friends and family, Dave.

HOWDEN: Exactly. But monetarily I'm not a very wealthy man, and I'm fairly happy about this situation, because I think, what a headache I would have if I had millions of dollars that I had to invest somewhere and I would really be staying up at night hemming and hawing, oh, where should I put this money, what's the best deal, what are some potential threats that my investments might have. So wealthy people are stuck with this problem: where are we going to put our wealth, where are we going to put our savings so that we can get the best return. Or even right now so that we can protect it, so that it doesn't get confiscated through taxation.

And so these business owners and the rich in general, they've really got this difficult decision that nobody really pays attention to, which is what would drive them to invest outside of their own country versus taking the easy road — and it is the easy road — leaving your money in your own country and just funding domestic investments. And if you want to dive into it, it's a lot of work to make an investment in some other country compared to just calling up your stockbroker and saying, hey, buy me 1,000 shares of Ford, or buy me 100 shares of General Electric or something like that. It's a lot of work to take your money out of the country, so what's driving or what potentially could be driving people to do this? And again, for business owners you'd have to say, well, maybe it's easier to do business in other countries. Maybe they have a more competitive tax system. Maybe they have fewer business regulations or a tax code that is easier to follow, etc., etc., and that's why they would be getting their money out of the country.

WOODS: I want to ask you a question that is tangentially related to this, but it's something that came up in my mind when I was reading this. There's a movement in the US that's existed for a long time, and I'm sure it's all over the world, either to "buy American" or to "buy local," and there are many reasons somebody might want to buy local. I can think of a lot of perfectly adequate reasons, and they might not be strictly economic reasons or efficiency. But the point is a lot of people would say we should buy local, first because we want to support our local people; we want to support our neighborhood. But always at least implicit and sometimes explicit in this is that we don't want the money leaking out of the neighborhood. We don't want the money leaking out of this community or this county or this state or this country, because if the money goes somewhere else, then we lose it, whereas if we can keep it circulating in the community we can keep the wealth going. Is there something wrong with that way of thinking, that if we can keep the money in our community this is better than if we buy salsa from New York and the money goes out to New York and we never see it again?

HOWDEN: Indeed. Why don't we just take it to the logical conclusion? If money leaving your own community is a bad thing, what about money leaving your family? Why don't we just make every family an isolated island where we will do everything ourselves, and thus all of the money that we have will never have to leave our own homes? And of course for most of your listeners — and I'll give a personal example. In my family there's three: my wife and our one-year-old son and myself. I'm going to claim giving economics lessons. That's what I'm going to do in our family. I don't know what the other two are going to do. Hopefully grow food and make food and things like that. But of course we would have a very subsistence lifestyle. And the reason why is because there is no scope for the division of labor for any of us within our family to pursue the things which we are best at.

One of Adam Smith's greatest contributions in *The Wealth of Nations* was in describing what he referred to as a virtuous cycle, that as the size of the market grows it allows for greater and greater division of labor, greater specialization and efficiencies in production that will then allow for greater goods to be produced. And then of course the more goods that are produced, the more satisfied consumers can be. And so this whole idea that we don't really want to buy from a foreign country or a different state, we only want to spend locally and keep money in our community, it ignores this whole process that would allow for greater specialization and greater efficiencies in production, and it's false savings. You would stop money from leaving your own community, but at the same time you would stop other people from taking advantage of the specializations and the efficiencies that you have. The things that you do really well, other people, foreigners, would not be able to take advantage of that. So I think it's a terrible statement, and if anybody, like I say, brought it to the full conclusion, just isolate your family from the rest of the world and see how long you survive for.

WOODS: If I may change the subject just briefly, you are the editor of the journal of *Prices & Markets* — at least last I checked. You still are?

HOWDEN: I am.

WOODS: And are you — what is your role in the conference of the same name? What is the name of the international conference that Mises Canada holds?

HOWDEN: Well, I'm glad you brought it up, because Mises Canada is hosting its fifth annual International Conference of Prices & Markets, coming up soon. It's November 4th and 5th, first Friday and Saturday of November —

WOODS: 2016, because sometimes people listen a lot later.

HOWDEN: That's right. So November 4th and 5th, and it's at the University of Toronto in downtown Toronto, Canada, so if any of your listeners are out there in Toronto or are looking for a great weekend, a great Friday night and Saturday, I invite anybody to come on out.

WOODS: I will link to that, by the way. It's TomWoods.com/747 for today's episode. I'll link to that event. I'll find the link and get it over there. In terms of speakers, I know you'll have papers and stuff. Is there anybody we might have heard of who'd be there — other than you?

HOWDEN: I'll be there —

WOODS: (laughing) Yeah. I already anticipated that.

HOWDEN: Well, the applications are still coming in. Last year we had Joe Salerno and Mark Thornton come up, so we do have quite a few big-name speakers that your listeners would be familiar with. And the topics range from philosophy, Austrian economics, free market, government intervention — those types of topics are what we discuss.

WOODS: Well, sounds great. I'm trying to think, while I have you on the line, is there any last bit of wisdom I can get out of you, any last question that I could ask, because I'm pretty satisfied with your answers. But I've got Dave Howden on the line, you know? I can't blow this opportunity. I've got to ask him something. Well, I just saw your most recent article in the journal, which might be a little bit on the technical side, but are there other things that you're working on that a popular audience might appreciate?

HOWDEN: Well, I'm teaching a class here at Grove City right now on the evolution of money and banking, where I —

WOODS: Yeah, I want that course for Liberty Classroom. That sounds really great. So tell us about it.

HOWDEN: Well, what we're doing, we're starting with — we're doing a revisionist history of sorts of where money came from, what its origins were, what roles it serves. And then we're using this in the later part of the course to describe why the Federal Reserve exists. And it's an interesting question, because in the middle of the 19th century America had a fairly free market monetary system. We had private banks issuing money, and you know, all things considered — a couple quibbled here and there — it was fairly free market-oriented, and then gradually over the course of the latter half of the 19th century and then leading up to 1914, we ended up with centralized, basically government agency in the Federal Reserve. So in the second half we trace out all the little problems that happened over that 65-year period to describe why it is that the Federal Reserve emerged, where did it come from, what are some of the terrible things — we know some of the terrible things that it's doing now, and we have some instances, some episodes in the past that we can look at for bad things that have happened because of it, but really I want to look at all the little bad things that happened from government laws in money and banking in the late 19th century that resulted in the Federal Reserve being formed in 1914.

WOODS: Have you considered writing a book out of this after you're done with this course?

HOWDEN: I would love to if I can find the time. So I'm researching it. I've been researching it for several years, and then the course is an opportunity for me to organize my thoughts into something that flows a little bit more naturally, and then hopefully if all goes well, yeah, I'll pound out a book — hopefully sooner rather than later while it's still fresh in my mind.

WOODS: All right, well that sounds great. Well, it's too bad — here you are in the States, and I basically have no opportunity to see you, so it's unfortunate. Dave is normally in Spain and once in a while in Canada, but one of these days I'll catch up with you. It was great to see you over the summer, and I know everybody listening appreciates your time today, so thanks a lot.

HOWDEN: Fantastic, thanks a lot, Tom.