

THE BUSINESS CYCLE

Because Keynesian and Monetarist business cycle theories were linear, they attributed recession to a deficiency in (aggregate) effective demand. Their limited one-dimensional capital theory assumed that consumer demand generated investment demand through a multiplier based on the historical ratio of consumption to investment. By contrast, and 180 degrees from this, the Austrian theory embraced the commonsense conclusion that more spending on consumption reduces the availability of spending on investment. From this standpoint, exactly the wrong prescription for relief from a depression came from the dominant schools of economics.

Why holding down interest rates doesn't help: It has been thought that if the end of a period of low interest rates caused a recession, then logic would argue for reinstating the policy of lowering rates to end a recession. However, the reason a low interest rate cannot return us to the boom of the expansion is that the expansion was a period of ongoing, ever-worsening alignment of complementary productive processes, elevated employment, and GDP notwithstanding.

Austrians have emphasized the folly of thinking of the economy as either enjoying more or less economic activity. Their more sophisticated model is common sense. We can consume capital on the one hand and invest in the wrong capital projects on the other. Each of these contributes to GDP. But each of these subtracts from the ability to deliver supplies of usable goods and services in the future.

A correction has benefits. The correction must not only revalue these misappropriations but also liquidate them at a loss and terminate whole enterprises that are most out of line with balanced production. The workforce must be relocated and retrained.

A community could begin a project to build a tunnel to access what requires a difficult journey over a mountain. It could employ plenty of engineers, train workers in demolition and excavation, and invest in heavy equipment. But if, halfway through the mountain, the community runs out of the means to support its workers, then when they return to their original activities, they have nothing to show for their work and are worse off for having depleted their resources.

Yet, while engaged in the project, they were experiencing a boom in employment and economic activity. Their economists said they were on the right track because they enjoyed a high level of aggregate demand, but they were misled about their provisions, as the authorities distributed them at a rate that would deplete stores faster than they could be replenished. Artificial credit stimulation can have similar results.

Low interest rates were a post '08 policy target. Price spreads (business profit rates) underly real rates, not the other way around. In recovery rates lowered by **QE** & prevented from readjusting, curtail future growth. Post-boom input & factor prices, when not allowed to readjust, remain too high for profitable enterprise. Price spreads between inputs and

outputs constitute the ultimate basis of loan rates. Hence, low rates can reflect economic malaise. Further rate suppression can lead to capital consumption and harm savers.

Suppressing interest rates suspends the culling of economic dinosaurs. It spurs real estate booms, biasing capitalized values of land, which, unlike capital goods, benefit from future income streams that do not depreciate.