Austrian School of Economics and the Theory of Business Cycle

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Abstract. *When will the new crisis come? It is the question that lies on the lips of all economists. But maybe the crisis has already arrived, it's in our midst, and economists know that, but they do not have the courage to say it. We believe that those who hold the reins of the world economy desperately postpone its emergence in the short term, fearing the unpredictable and, above all, the predictable consequences. A new world order will appear in which Western culture will move to second place. The West forgot the principle that built its economy, that principle of saving, and learned the wrong principle of spending. Others did the opposite. Economists, relentless observers of life have tried to seek explanations for the recurrent fluctuations in human activity. From sunspots to expense (too large or too small) explanations were insufficient. The latter kind of explanation approaches philosophy and psycho-analytics. Sedlacek and Tanzer believe that the problem is deeply embedded in the human mind, in the way of thinking and behaving, this aspect owing to the unconscious structure of the Western mind. The West has created the bloodiest and greedy civilization with individuals full of psychic trauma. Invariably, these issues lead to a crisis. There are at least three Nobel Prize laureates on the study of human behavior in the economy. Is it possible for crises to defend because of our way of being, over which we have no control? We believe not. In our view, past and future economic crises have only one explanation: the destruction of the nervous system of the economy by forgery of money. Money forms matter, a matter that transports the economic signal; a signal indicating the rarity of resources, existing needs, and business opportunities. A banking system, supported by the state bureaucracy, manipulated the signal, corrupting it. In economic literature, we are talking about bringing opportunities from the future to the present by manipulating money. We think it's wrong, time cannot be manipulated. Through the present article, we want to show that by the a priori power of human reason an economist can surprise the essence of economic processes without necessarily requiring an empirical cut of reality. Through the Austrian School of Economics, we believe that we are approaching the true explanation of economic crises, and mainstream literature does not have a veritable explanatory power.*

Keywords: *economic crises, money, credit expansion, economic illusions, failure*

Introduction

Greed. Was he a Roman patrician less greedy than a current economic agent, was he a feudal noble less greedy than a modern entrepreneur? Of course not. Greed is eternal in human existence and the permanent accompaniment of human destiny and civilizations. However, throughout the history of mankind, there is only one great civilization in constant evolution, to whom the others are just pale children. This civilization owes its greatness to its economic strength.

Oswald Spengler believes that the civilization in which we live is a civilization due to the Germanic spirit of German justice and vision of space, time and change. Jung and Lucian Blaga believe that each civilization is an application of the deep structures of the unconscious in the external, concrete, material world. I consider this misconception and believe that the whole capitalist civilization is a concrete application of the Christian spirit of private property.

There are studies, much prized about the unconscious manner of people's behavior, studies that attempt to extract general principles and trends of historical evolution, we consider these studies to be only an intellectual play. The true essence of Western civilization is respect for property.

We consider the work of Sedlacek and Tanzer wrong, a work that finds the germ of the current economic crisis in its own unconscious behavior of the Westerners. These problems existed before. Solutions that are based on misdiagnosis are disastrous. Instead of applying the right remedy, there are drugs that destroy even more. The problems that we see are in disregard of the essence of the current civilization, that is, the concept of private property.

Technological innovations have existed in other civilizations. In the 4th century, the Greek engineers in Alexandria discovered the steam engine, Chinese innovators are creating all kinds of devices that could have made it easier for them to work. But they are not applied for one reason, private property has not been respected to the end. The interventions made by those who hold power have always blocked innovations, innovations that might have questioned their power. The same types of blocking are now found in bureaucratic structures.

There are whole libraries of books that make a list of economic crises; from the dawn of capitalism until now. In them are listed all kinds of reasons and circumstances. Some contexts are singular; others are repeated in some kind of pattern. I believe that there is only one real reason for the economic crisis, that the concept of private property has not been seriously respected, and in some way or other it has been attempted to circumvent the rules by lack of transparency, deception, etc. In the nineteenth century, Keynes theorized theft by renaming it: to bring future consumption to the present. A simple deception.

Mainstream and economic cycle theory

Reasons for economic crises: 1. With the abundance of saving on the world market, foreign credit was easily accessible. 2.Loose monetary policy, low credit interest. 3.Unfounded financial innovation: complex value gadgets have been created, built on various types of loans that have been combined in various ways to dilute risk. 4. The issue of moral hazard; the agents operating on the banking market had the certainty that they would be saved by the central bank no matter what they would do to take unjustified risks. 5.Banking: they took risks with only a limited time perspective in mind. 6.Parallel banking system completely unregulated and unattended, a system that has reached the official level. 7.Over-indebtedness at all levels. Going on the over-indebtedness of financial institutions to any asset purchase has a small percentage of equity and a large percentage of borrowed capital. At any impairment of the asset, equity disappears. The borrowed assets and/or capital assets are sold on the demand to return the asset borrowed by the lender when the lender realizes market weaknesses. When everyone has the same behavior, the actions collapse.

Considering the above-mentioned, mainstream connoisseurs report in their work the surplus and unused production capacity and talk about a global overabundance of savings. The country's savings have served to support excessive consumption elsewhere. At the time of the crisis and in case of insolvency of some countries, the documents attesting to the loan are no longer worth the paper they are written on.

The central economic thinking channel does not understand the role of saving. He sees in saving only a reduction in spending that leads to a recession. Central banks have the role of maintaining price stability by increasing the amount of money in the market with a sufficient rate of fixed price maintenance and a second role in securing liquidity in times of crisis.

Within this theory, prices and wages are not immediately adjusted to the balance when demand and supply are in imbalance. Product prices are seldom changing as a result of changing demand. Salaries change slowly with changing labor market conditions, and people's expectations about economic growth are slowly improving.

All these rigidities lead to temporary disparities between monetary change and price changes. Short-term rigidities are nominal rigidities that are price and wage adjustments in line with changes in demand; expectations of rigidities that are adjustments to inflation expectations.

Crisis remedies in a mainstream vision: 1. A recast of remuneration is required. Agents operating on the financial transactions market must be remunerated on a long-term basis for results. 2. Securitization regulation is necessary: a careful assessment of initial loans; the standardization of securities created on loans; transparency in how to build titles. 3. It is necessary to reform the rating agencies to ensure their professionalism and independence. 4. It is necessary that the derivative securities used to cover risks to be transparent and standardized. 5. It is necessary to break the financial companies too big, which do everything, in small specialized firms, firms that do not put economic problems through their disappearance. It is necessary to separate the field of action of the companies so that they do not become contaminated. 6. It is necessary to obtain long-term loans by banks so that they can borrow in the long run and not the short-long practice until now. 7. All businesses must be regulated. Not only some companies are removed outside the stock exchange and regulations, then through these firms to trade in uncertain assets, and finally be saved by the state at the expense of the taxpayer. 8. In order to stop speculative balloons, it is necessary to establish a quantitative ratio between the different types of assets and the liabilities - the reserves of the bank. 9. For investment banks, it is necessary to set a certain amount of capital as the minimum threshold for which to buy securities but only to a certain margin against the threshold.

Foreign investment is massively entering the country on the basis of savings in other countries. Usually, foreign investments buy short-term paper with various assets at the base. Buying assets are appreciated quickly creating the premise of building a speculative boom. The consequences: private consumption increases, investments the same, the current account deficit is amplified. Major deficits arise, debt increases due to investment, speculative ball crashes, country defaulting, currency collapses. It was found that if investors observe that investments do not go into infrastructure they will cease refinancing the debt and refuse to buy new debts.

Short-term loans must not reach the critical mass from which investors will refuse to roll over the loan. Even if loans are invested in production, infrastructure takes time to bring benefits. The impatience of politicians in implementing projects over the real possibilities of a country creates the conditions for overcoming the critical mass of short-term borrowing and leads to the balancing of the economy to destruction. More briefly. Investments go into the country and this leads to a lower saving rate, which in turn leads to increased consumption, consumption is intensified by the tax reduction and thus accentuates the current account deficit.

Austrian School of Economics and Economic Cycle

In order to understand the business cycle, it is necessary to understand the reasons behind the behaviors that lead to the outbreak of a business cycle.

The meaning of a bank is the granting of loans, from where, through the interest charged, they obtain the necessary profit. The logical implication: the more borrowing the more profit you get. Even if some credits are not performing and will be passed on losses, they do not significantly change the balance sheet. This happens if they do not exceed a certain percentage for each bank depending on the economic situation. Banks diminish their risk if they increase their credit by increasing the money supply on the market; that is, it increases the asset over the held. In general, the multiplication of the asset takes place at a certain rate. In this way, even if some money borrowed does not return to the bank, this does not really affect the bank because it has borrowed fictitious money anyway.

The government has a reason to trigger inflation because in the limited perspective of time it exists and for which it plans, it makes inflation beneficial in increasing its own income, triggering government spending, and with its help: subsidizing power-friendly groups. The first step in triggering the economic cycle is the expansion of bank credit and implicitly the national money supply. This is due to the phenomenon of current deposits. Credit expansion occurs because the central bank reduces the interest rate on loans below its natural rate by buying assets on the market. Increasing credit will lead to higher prices and inflation.

Another phenomenon of credit expansion is: allowing banks to raise loans with a certain rate on deposits from banks. In other words, if a person deposits a certain amount of money in the bank as a deposit, the bank is required to deposit with the central bank a certain percentage of the initial amount and borrow the rest multiplied by a certain rate. This happens even though the sight deposit can be liquidated by the owner at any time. Other ways of multiplying bank credit: short-term borrowers and long-term loans; completing the available capital of banks with a lot of loans over their original capital; so the ratio between equity and borrowing is totally disproportionate.

The far worst aspect of lowering the interest rate below the natural market rate is the deformation of existing economic information on the market. We believe that the price and interest system is a system similar to the human nervous system, that is, a system that transmits signals filled with information, and money the means by which computer signals are transmitted to the market. Fake interest means not only the destruction of the nervous system of the economy but also its deformation in a random manner; misleading it. If agents do not have information and are aware of this they have a certain type of behavior in such situations (they try to collect information from other sources and process them by giving them a certain probability of fairness) but if they have completely erroneous information about certain aspects, information they take as correct, then their behavior is directed in a completely random way. As a result of misguided entrepreneurship by bank interest rates, they make erroneous, irrational investments.

On the free market, the bank interest rate is usually given by the preference of time. During a loan, a good present (money you use now) is changed to a good future (money used in the future). People always prefer a thing that is used today for something used in the future. In order to bring equality between the two, again, an amount must be added to the good used in the future. An agent to renounce a present object in view of its future use must earn something, a rate, and its value changes according to how much people appreciate the present or future, that is, the preference of time.

If people have a low preference, they prefer to consume in the future rather than today, that is, they prefer to save rather than consume. Saving is a sacrifice from consumption, i.e. not consuming a good product in the past. If it is saved more as a result of a low preference, then the interest rate decreases, which leads to lower investment costs. In Austrian theory, the level of savings is equal to the level of investment. Investments will increase as the rate at which money is borrowed decreases.

Agents can hoard money instead of depositing them in banks, but the hoarding continues until the costs of the treasury become too high compared to the savings-bank investment benefits. There is also the alternative of hoarding: the destruction of saved money, but in this case, the implicit event is to increase the purchasing power of money left in circulation.

Briefly, the short-term preference leads to an increase in the savings/investment versus consumption ratio and the interest rate is decreasing.

The fall in the interest rate may alternatively occur through the disturbing action of the state and of the central bank. Banks will create money through the mechanism of deposits granted as loans and having the same role and function as the fiduciary currency. By increasing the automatic money supply, bank interest is artificially diminishing without taking into account the real-time preference of the population.

At the moment when interest is artificially decreasing on the market, it throws out the wrong information, that the preference for time is low, and the economies are growing. By lowering interest rates, certain investments become profitable, before those investments produced market outcomes that could not be sold at the price level to cover production costs and, implicitly, fundraising costs.

Investments will mainly be in areas that deliver higher returns than the market average, in time-consuming and capital-intensive projects at the expense of consumer goods. Agent behavior will be the same (as) as in the case of savings growth as a result of less time preference.

Increasing the level of investment will lead to increased demand for labor and wage growth. So the resources will be diverted from their use according to the preference of existing time, i.e. from the production of consumer goods to capital goods. Because resources are limited at a certain point in time and can only grow at a certain rate for a given technological development, diversions of resources are being made to certain industries to the detriment of others. There are anomalies on the market in the sense that certain goods appear on the market in the absence of complementary goods, i.e. we have cars but we do not have motorways or gasoline is expensive in the absence of investment in extractive industries, etc.

Workers who receive increased wages or newly hired workers (as a result of increased investment) start to spend money because the time preference of the population has not changed and they prefer consumer goods so that the old consumer/savings ratio is restored. They do not save enough for the capital goods industry but rather focus their resources on consumer goods. Initially, the existing stock of consumer goods sets increased demand. High demand for capital goods increases their price, and consumer goods prices are rising at a certain amount of time. Thus, the old consumption/investment ratios are established and it is found that too much investment in capital goods and too little consumer goods are invested. The agents acted on the market as if economies were available in sufficient quantity. After the wave of money has gone through and has gone through the economy, the old preference-time ratios - interest-savings-investments are established, but after the misallocation of scarce resources to misinvestment is observed.

Serious distortions occur in the economic system. Wages, capital goods prices are far too high to be used efficiently when the real preference of time and natural interest rates are asserted on the market. Depression is a period of adaptation in which the irrational investments are liquidated and re-establishing the relations: consumer demand desired by the population. It is necessary to eliminate the wrong investments, resource allocation errors and return to the normal functions of the economy. Producer price indices have to fall to the values given by normal market interactions because they have been greatly demanded in the creation of capital goods.

Credit expansion will change: the absolute value of all prices and prices relative to each other, i.e. relative prices. During the expansion, capital goods prices are rising more than consumer goods prices, so during the depression, capital goods prices will change sharply down. This is happening during the reallocation of resources to the desired goods of the population. With the contraction of the credit, the prices will be contracted but differently from each other.

While massive investment takes place due to credit expansion, the price of production factors increases and this price will be transferred to capital goods and ultimately to consumer goods. Consumers will have to prioritize their consumption as consumer goods prices have risen so that many businesses cannot maintain their profitability and fail.

If the process of flooding the money market does not stop then the consumer goods market will be assaulted by consumers for various goods. Resources are limited, production factors will be exhausted or will have prohibitive prices, so that chain failures are needed to re-orientate production factors in the required areas.

Cycles take so long, and adjustments do not take place quickly because credit expansion takes place at a rising rate. Credit feeds are increasing, repeated and accelerated, i.e. they are higher than in the previous situation and are administered at shorter times than they had previously been administered. At one point the system becomes unstable in particular the banking system and the credit expansion must be stopped and the pain adjustment period begins. The longer the boom has been, the more the wrong investments have been and they have to be corrected.

A new cycle begins when the necessary adjustments have taken place, liquidations and bankruptcies have ceased, the economy is recovering, so banks are resuming their habit.

In the growth phase of the cycle, capital goods prices are rising faster because here money is invested from the expansion of credit. Money comes to workers with a certain delay and they spend this money so that there is a gap between rising prices of capital goods and consumer goods. The gap is increased by the buffer consisting of past stocks accumulated at the old prices. In the depression, capital goods prices fall sharply and much more normally because these prices were fueled by waves of money coming from banks. In the depression, it is necessary to return to the values established by the market through free interaction and to the normal relations determined by the preference of time.

Since the elimination of the gold standard and the crisis of the 1930s, there has been no contraction of the money supply, in reality, there is a permanent increase in the money supply, increasing with different rates. Normally during the depression, consumer goods prices fall less than capital goods, and people are enjoying low prices for consumer goods. But once the market is continually fed and stimulated with money, there is no price drop but only permanent nominal growth, there is a general price increase. So in a recession, we also have inflation and unemployment.

In short, instead of a conclusion: the secret and the key to explaining the Austrian theory is the concept of scarce and limited resources and their erroneous allocation because of erroneous information distribution on the market through the Central Bank price system. The price system is a system of information about the relative scarcity of various factors of production, consumer goods preferences and of the time preferences of the population. Without this information system, agents simply swear in the dark making decisions randomly without any landmark.

By deforming the economic reality perceived by agents, that is to say, the image of realities in the minds of agents, this being done by altering the information held by the price system, entrepreneurs are guided erroneously in the complexity of reality, making valid decisions in completely different conditions, even under conditions opposite.

Agents by expanding bank credit are left to believe that the population saves much of their income so that resources are available for investment and especially investment in capital intensive production processes that require a long-lasting realization.

In order to build a complex good, it is necessary to have a previous saving, i.e. abstain from consumption in order to possess the resources needed to create that complex well. Every complex good incorporates in it an increased amount of factors of production. There is a direct proportion between the degree of complexity and the degree of incorporation of the factors of production.

There is an ascending scale of complexity of goods. In order to move from one level of the other to the complexity of the goods, it is necessary to create the goods on the lower level in order to move on to a higher level. This is not enough, there is a need for resources to be used to move to the next level. The availability of these resources, i.e. their existence can only be achieved by building them and refraining from consumption (not consuming them), i.e. saving them. If there is no saving, goods with a higher degree of complexity cannot be achieved.

There is also the issue of obtaining resources and their destruction, but this is about pathology, not economics, and the incidence is probably very small and does not really matter. There is also the need to remove resources from the productive circuit and unnecessarily store it. This may resemble destruction, but in principle, those who retain the resources do so until they find the necessary opportunities to throw them into the economic swing or the cost of keeping it becomes too great and it is more beneficial to invest; at least these are the rational aspects.

Physical resources have equivalence in the monetary system; they are two sides of the same coin. That is why any deformation of the monetary-financial system is a distortion of the available resources; through resources understanding the primary factors of production and capital goods existing on the market at a certain point in time.

As basic elements of Austrian thought to understand the theory are capital goods that are physical objects guided for purposes by individuals. By the action of each individual, a certain structure of production changes over time and cannot be predicted. For Austrians the interest rate is the adjustment of the value of future goods to the present assets, the rate appears on the market during agent interaction according to their real preferences. Entrepreneurs supply the production factors with the present goods in return for the property of future goods, and thus the production structure and the time market appear. Thus marginal productivity tends to equalize the interest rate.

The Austrians build their judgments by the deductive logic method. Austrians start thinking from a few obvious axioms, axioms that are related to the economic reality; axioms are extracted by the essence identification method, then the implications are deduced from these axioms. The first axiom is that of human action: people choose goals according to their own scales of values and seek appropriate means of achieving the goals; the second is the decreasing marginal utility law, that is because the resources are rare, they choose for the beginning the most valuable purposes and then in order, according to the scale of the following values; the third is the law of temporary preference, preference is given to good present to the detriment of the future good; the fourth tastes and capabilities of people are diverse; the fifth is that the action takes place over time; Sixth, people learn from experience.

The most serious problem of credit expansion is the distortions that appear at the level of the structure of production because the surplus of money enters through certain channels that feed certain industries at the expense of others so that the relative weights of the industries change relative to each other.

Another problem of concentrating investments in a certain area is that they produce goods that are unusable in the absence of complementary goods, i.e. highways are being built and cars are lacking.

Conclusions

The Austrian School captures the essence of the economic cycle is not respecting private property. The crisis and the economic cycle are a product of non-compliance with private property. This aspect is not taken into account by mainstream representatives. The condition of the existence of private property is the rarity of goods. An abundant good does not lead to conflicts. In order to avoid potential conflicts, exclusive possession rights have been attributed. With unrestricted credit expansion, property rights become superfluous because abundance replaces rarity. There is no longer the reality of the rarity of things, it is replaced by an illusory world of abundance in which the only cost (rarity) is the cost of maintaining the credit system. This is the road to the crisis.

Any interaction between people implies the existence of private property and implicitly of rarity. Including the mind and the human body are a rarity. Even in the Garden of Eden, there is rarity and opportunity cost. This is the human body that can only take action at a given moment and must give up on other actions. Where there is a rarity, there are conflicts, conflicts that will inevitably lead to rules. These rules include the 100% reserve banking system that preserves the purchasing power initially acquired through the act of saving. Purchasing power (obtained through human action, stored by an act of abstinence from consumption and preserved through a material object) enters the banking system mixer where it is diminished and corrupted by the existence of fractional reserves. Multiplication of bank credit without coverage creates the illusion of abundance and dilutes the rarity of economic goods. Efforts to obtain goods fade away and the road to the crisis is paved.

There is an objective relationship between the owner and the property and the right of the holder to conclude voluntary contracts. Handling these contracts through the fractional reserve banking system is a fake that leads to the crisis. By manipulating bank deposits, the banking system acquires ownership over which it is not entitled. This property has not been legally approached.

How will the future look like? Will capitalism be destroyed by not respecting its own principle of private property? Every crisis is overcome by "theft". In a perverse way, the economies of honest, honest, laborers are subdued, and the fire created by those on buttons is extinguished. Bankers do not follow a simple rule: do not steal; because what else than theft is: to borrow something that you do not have.

The result will be a future for the many and poor and the very few and very rich. The middle class is gradually thinning. The engine of progress is the middle class. They have the knowledge, desire, motivation, faith to change the future for good. The poor are too caught in the struggle for survival, and those rich in the struggle of pleasure. Ankyloses of civilization is the result.

On the stone on which Hammurabi's code is written, a long time ago, the jubilee is set at 50 years in which all the debts are wiped out. Why? Because a society with big differences in wealth is a society of revolutions, destruction. Envy, the resentment of the poor and many will destroy the society that allows it.

Wealth is always a relative concept. That is, people always compare each other. What will be done by those who constantly notice that no matter how much they work, how prudent they are, how much they save, how much they respect the rules of common sense, are they permanently deprived of financial security? No matter how much you save, you notice that what you have is gradually diluting. So you're encouraged to spend everything right now without thinking about tomorrow. What kind of future can we create in this way of the total lack of responsibility for tomorrow? Boccaccio in the Decameron will give you the answer.

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