A DOCTRINAL PROMENADE INTO THE HEART OF THE BUSINESS CYCLE THEORY: BRIEF AUSTRIAN HALT

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Abstract:

Throughout this paper we propose a brief doctrinaire promenade starting with the Monetarist approach, reaching the Keynesian doctrine and finishing with the point of maximum interest, namely the Austrian perspective regarding imbalances. Exhaustively passing through the theories mentioned above, along with their fundamental perspective regarding the phenomenon of economic cycles, does not represent the basis for the current paper. The specialized literature has no shortage of such work. The purpose of this research is to highlight the explanatory strength of the Austrian business cycle theory, establishing the reasons for considering it the best cemented one in regard to the recurrence of crises. For being able to arrive to such a judgment, we employed a contradictory approach between the Austrian doctrine and the Keynesist, respectively, the Monetarist one. The conclusions we reached reflect a healthy Austrian vision in regard to addressing the issue of economic crises. Therefore, complying the basic Austrian principles can ensure prosperity to the economies that decide to apply them.

Key Words: Crisis, Business cycle, Austrian School, Keynesian, Monetarist

Introduction

Approaching the theory of economic cycle is not an issue that comes in hand. We are permitted to make such a statement based on the idea that explanations concerning the business cycle theory are strictly related to how each school of thought was able to understand the system that determines the market, with its habitual basic functions, to operate; how was the idea of long-lasting prosperity understood and, last but not least, which is the role of the state in this entire bewilderment.

Although some of the dominant doctrines tend to insist on rather a few particular factors, considered to be the most important ones in regard with the responsibility for triggering crises, in fact the problem can be viewed from various angles. Based on this statement, nowadays the perspectives from which the business cycles can be disentangled requires the participation of a consistent number of elements that, according to different economic schools of thought, bare the guilt for economic disequilibrium; thus, the problem is either *monetary expansion, state interventionism, excessive regulation, lack of regulation, low level of consumption, various changes in consumer preferences* and so on. Trying to discern which factors bring more enlightening answerers regarding one of the biggest dilemmas that economy has had to face during the years, namely the recurrence of recessions, our attention was captured especially by the explanations coming from the Austrian School.

This paper is structured as follows: for the **first part** we choose to define the general framework of the present research by making concise referring to the problematic taken under consideration. The **second section** offers a brief overview of the business cycle theory starting with the monetarist perspective and passing through the Keynesian one in order to arrive, in the **third section**, to the point of main interest, namely the Austrian view. Emphasis is placed on some of the key aspects of the business cycle, more precisely, the channels through which the monetary injections are made and the manner in which they affect the production structure; the interest rate and the price level are also taken into consideration. The paper ends with final remarks.

The doctrinal inventory of the business cycle theory

The classical foundations of the business cycle theory can be identified, in a cohesive form, since 1860 in the works belonging to the French economist Clement Juglar. Based on statistical calculations, carried out in his research *Commercial crises and their periodical return to France, England and the United States (1862)*, Juglar was able to identify, as the main cause of economic fluctuations, the policies undertaken by banks.

Regarding another classical approach, we are particularly referring to the one formulated by Karl Marx. The author of the well-known book *The Capital* (1887) believes that the prejudices caused by the cyclicity of crises are rooted in the development of the capitalist system. Marx's view concerns the fact that periodic fluctuations are an integral part of the capitalist process. In this regard, he came to be known as the economist who assumes that business cycles have a due date once around 10 years; or, in other words, business cycles are decenal. His demonstration is based on the idea that the source of economic crises is none other than the constant tendency for renewal of fixed capital. A good use of capital, as well as the state of competition on the market, forces entrepreneurs to invest their profits and to continually seek innovative ways in which they can increase productivity. One of the best options comes, in this direction, from the increased mechanization of production which will lead, according to Marx, to the establishment of massive unemployment. Eventually, the strongly capitalized economy will get acquainted with the crisis.

J.A. Schumpeter transformed Marx's conception regarding the renewal of capital into the concept of *"creative destruction"* (Schumpeter, 1943). The significance of this precise process, a conceptual bridge between the two economists mentioned above, can be translated through the constant necessity to find new methods of production, new forms of organizing the productive process in such a way as to obtain the maximum utility out of the existing possibilities. For both, Schumpeter and Marx, this capitalist accumulation process can be viewed as recurrent periods of routinization that break off when radical innovations come along and shake up the economy. The "creative destruction" destroys the old era and brings a new one into play. The economy experiences a boom until new opportunities for investment are inevitably exhausted, generating a crisis and depression. Thus, according to Schumpeter, although capital accumulation is a significant factor, it is after all innovation which is the fundamental cause of business cycles, as they have the power to change the entire economy.

However, the most revolutionary perspective on the business cycle was formulated around the triggering of the strongest crises of the twentieth century, namely, the Great Depression; we are particularly referring to the Keynesian doctrine. Taking into account the perspective of John Maynard Keynes regarding the cyclicity of business crises, formulated in his primary book *The General Theory of Employment, Interest and Money* (1936), we unravel the fact that he thus succeeded reshaping economics on a series of new basic principles which could be, in a very general manner, translated into state interventionism. According to Keynes, *"... If the government refrains from regulation and allows things to follow their natural course, the essential commodities will soon reach a price level accessible only for the rich, the worthlessness of money becomes apparent, and fraud on the public can no longer be hidden"* (Keynes, 1920, p. 240). Hence, by embracing the macroeconomic perspective, the British economist is not able to compass all the changes that take place inside the economic apparatus. This determines him to infer that markets are unable to automatically provide full employment of labor force thus, in times of crisis there may be encountered long periods of massive unemployment if market is left to solve the problem. The state is invited to intervene and help resolve the imbalances, having recognized as necessary the task of boosting the economy. In the first instance, the need to boost aggregate demand for goods and services is referred to. Thus, for Keynes and his followers, contrary to the Monetarist but especially to the Austrian view, waiting for things to settle by themselves is costly and redundant.

Keynes never saw too much investment in the economy; on the contrary, he thought there was too little. According to him, the purpose of the investment involves the production of goods and services that will increase the general level of consumption. This will subsequently lead to an augmentation in the volume of money spent by population, thus to social welfare: *"... the essential characteristics of the business cycle and especially its regular succession of movements as well as its duration, entitles us to speak of a cycle that is due, above all, to the way in which the marginal efficiency of capital fluctuates. The fairest thing that we can do is to look at the economic cycle as a*

phenomenon caused by a cyclical change in the marginal efficiency of capital, though complicated and often aggravated by associated changes of other important variables, on short-term belonging to the economic system" (Keynes, 2009, p.329). Therefore, regarding things from a Keynesian perspective, the problem must be sought inside the apparent collapse of investment spending. According to the ideas promoted in his *General Theory*, investment indeed depends on the volume of savings.

However, what imports is the way in which savings are determined. From his point of view, a very significant part is played by what Keynes refers to as *"forced savings"* (Keynes, 2009, p.141). This type of savings represent *"…the surplus of actual savings beyond what could be saved in the long run equilibrium, under conditions of full employment of labor"* (Keynes, 2009, p.142). It is this partucular kind of savings that, in his acceptance, bare the guilt for the lack of sufficient funds needed for investment, later on, for unemployment and, eventually, for recessions.

The determination of savings also depends, in the Keynesian vision, on the business prospects and on creditors preference for liquidity; this latter aspect represents the one that establishes the market level of interest rate. Therefore, for Keynes there cannot be expressed any guarantee of the fact that an enhanced propensity to save, which occurs only when an augmentation in the social income is sensed, will cause an increase in the volume of investment. What Keynes wants to emphasize is precisely that the economic future abounds in uncertainties which determine entrepreneurs to act, mainly on the basis of animal spirits rather than on rational calculations. *General Theory* is hence trying to highlight that expectations are inconsistent, therefore investments, under the form of aggregate spending and employment, will be characterized, on a permanent basis, by volatility. This aspect, strictly linked to an unregulated capitalist system, will inevitably lead to the onset of strong economic fluctuations that will require government remedies to counteract the apparent weaknesses inside the market. And these proposed panaceas consist of measures to enhance aggregate spending.

Largely due to the support given to state involvement in the economy, the criticism oriented towards Keynesianism is mostly coming from the liberalist part. For Hayek, Keynes theory marks the way at which end lies a high level of government intervention that obstructs the proper functioning of the free market. According to the statements made by Milton Friedman, the Keynesian view of the business cycle *"... behind the vague math charts is simple and rather naïve"* (Friedman, 1998, p 126).

The Monetarist doctrine, initiated by Friedman, strongly advocates for a substantial reduction of the state role inside the economic mechanism. From this point of view their doctrine resembles the one belonging to the Vienna School. This is, in fact, one of the very few binders **linking these two schools of economic thought**; things change when arguments and proposals concerning the recurrence of crises are brought into discussion. If the Monetarist current finds the augmentation of the monetary base as the main solution to overcome imbalances, denying the inflationist phenomenon that inevitably arise from that expansionist action, the Austrian School declares itself vehemently against any version of monetary expansion; and this is because, in the Austrian sense, any attempt to expand the money in circulation considerably reduces the value of money and thus causes inflation.

A common issue for both the representatives of the Monetarist and the Keynesian tenets is related to price stability. For the representatives of both doctrines it is indicated that prices be stabilized, although, as we already know, market prices are determined on the basis of the free confrontation between supply and demand. It is all resumed to consumer preferences; therefore, volatility proves to be, in fact, the basic feature. Prices are sensitive to any change that comes from the part of demand, when consumer preferences change, or supply, when it is registered a decrease in production due to various interfering factors. Therefore, any recorded evidence of price level stability betrays state intervention. This deduction determines the adheration of Austrian representatives, the advocates of a healthy market economy, functional only under free competition and private property.

Thus, discussing about the perspective of Austrian economists, we note, from the very beginning, that they base their approach on the interdependent relationship established between the amount of currency and the price level. They neither believe in the neutrality of money, namely the Keynesian approach, nor in the advantages of an expansionary monetary policy that could solve the problem of recessions, in accordance with the Monetarist vision. Therefore, Austrian representatives do not believe in the formulas associated to the quantitative theory of money and sharply criticize both the ensuing inflationary measures and the principle of price stability. **From their point of view,**

inflation rests at the stage of unnatural price growing, an increase which is not based on the sound principles of free market but **is induced by monetary expansion**; it may come from either central banks or commercial banks, operating with the system of fractional reserves.

Undoubtedly, the business cycle theory is one of the most vigorous Austrian contributions to economics. The traditional Austrian position regarding business cycles starts with the interdependent links that are established between price theory, capital theory and monetary theory.

According to Austrian economists, in the initial expansion phase of the cycle there is an increase in the volume of credit that floods the economy. This generally occurs by lowering the interest rate below its natural or wicksellian level, i.e., the one that would prevail in the absence of monetary fluctuations (Wicksell, 1898; Mises, 1963; Hayek 1935; Rothbard, 2008) and will subsequently cause an increased price level. Broadly, the business cycle can be briefly explained as follows (Rothbard, 2008): in a harmonious market economy emerges a credit expansion encouraged and promoted by the government and its central bank. As banks increase their money supply, both currency and deposits, granting loans to companies, they push the interest rates below the natural rate of time preference, meaning below the free market rate that reflects the proportions, freely coerced by public, between consumption and investment. The first visible effect is therefore a relative price increase of all the materials required for production. As the prices of production goods will grow ever more, the return on investment will tend to fall. If the credit expansion does not accelerate, the rising level of production goods prices will catch up the commodity prices, leading to a sharp decline in profitability. The crisis is triggered when, at the existing prices, producers cannot sell their goods (Mises, 1963, 1981).

The interdependence liaison established between the level of saving and that of investment, the central explanatory point of the Austrian theory of the business cycle seems to overlook both Keynes and Friedman. The first sees things completely different from the Austrians belonging to the Vienna School. The idea that stands as a basis for the "economist of the Great Depression" is that saving decisions belong only to individuals and depend on their income, while investment decisions are subject only to the expectations expressed by entrepreneurs. Therefore, if these expectations manifested by entrepreneurs, are positive, they will determine a higher amount of investment, and vice versa; if expectations are negative, there will be a contraction in demand that may cause depression.

For the second economist mentioned in the lines above, namely Milton Friedman, an increasing amount of investment can only be determined by an augmentation of money in circulation. Therefore, from a Monetarist point of view, the quantity of money is directly proportional with economic activity. Money injections lead the economy towards investments that generate prosperity, while a decrease in money supply lowers the return on investment thus leading to the emergence of imbalances.

The Austrian doctrine comes, however, to resolve, via a plausible system of argumentation, this apparent dilemma related to the type of relationship established between saving and investment. **The key is capital theory**; namely the intertemporal perspective on capital, an approach with a high explanatory power, which however is absent from both the Monetarist and the Keynesian doctrines.

Austrian approach – A sane perspective

The marginalist movement of the nineteenth century, although it has revolutionized the foundation of economic thought cemented until then, apparently failed to convince economics to borrow its basic principles. Therefore, nowadays, most economists still consider economic problems in terms of aggregates. We are thus entitled to envisage that the ideas on which the marginalist thinking was grounded remained yet misunderstood by some economists who seem to refuse to pervade the meaning of the reflection according to which, at the core, it is the marginal and not the total value the one that determines, in the first instance, the importance and, subsequently, the need for a good in production or consumption. The approach thereby becomes a "borderline" one as it is admitted the importance of the last unit belonging to a good, either owned, consumed or exchanged.

The architecture of the Austrian business cycle theory is based on six pillars. In the first instance, we are discussing about the *marginalist approach*. The second pillar is represented by the *methodological individualism*. Thirdly we discuss about the *methodological subjectivism*. The fourth pillar refers to the incorporation of *time preference structure* developed by Böhm-Bawerk, both in

terms of production and especially of consumption. Number five is the wieserian concept of *opportunity cost*. Last but not least, *market deregulation*.

With strong roots in Menger's *Economic Principles*, as well as in the precepts provided in the works of Böhm-Bawerk and Wieser, first Mises in 1912 and after, with significant improvements and contributions Hayek in 1933, were able to develop, in a very clear manner, the mechanism through which monetary expansion, accompanied by loans that exceed the rate of voluntary saving, could lead to a misallocation of resources, affecting, in particular, the structure of capital. Mises (1963, 1981, 2002) applied the approach based on methodological individualism and subjectivism to the monetary theory; Hayek (1933, 1935) used the same classical Austrian approach, to which he incorporated the monumental monetary demonstration designed by his contemporary Mises, making both adhere to the theory of interest. His theory betrays emphasis placed on the issue of time preference, but especially on the theory of capital, namely, the way in which monetary injections distort the allocation of capital within the production process. Thus, together, the two economists founded the Austrian business cycle theory, a complex and logical theory that once understood can represent a real saving treatment for the economy that chooses to apply it.

Monetary aspects of the Austrian business cycle

In light of the Austrian view, there are two ways in which investment can be financed. The first consists of people’s voluntary savings reflected in the natural rate of interest and corresponding to the sustainable boom. The second refers to monetary injections reflected in a level of interest rate which is below the natural rate one and is included in the analysis of the unsustainable boom. The latter action can, in turn, be decomposed in monetary injections that come directly from central banks or the ones operated by commercial banks through the fractional reserve system.

Central banks are either, literally, printing money or choosing to lower the refinancing rate level, when facing the situation of saving commercial banks that operate on the principle of moral hazard.

Regarding commercial banks, these institutions have the legally accepted possibility to increase the quantity of money in circulation by creating credit based on demand deposits; this type, unlike time deposits may be withdrawn at any time and should be always kept 100% available to the depositors. Thus, *„The bank creates new money out of thin air, and does not, like everyone else, have to acquire money by producing and selling its services. In short, the bank is already and at all times bankrupt; but its bankruptcy is only revealed when customers get suspicious and precipitate "bank runs"* (Rothbard, 1990, p.27). However, in doing so, the bank is able to use the depositors' money for its own purposes and obtain profit.

According to Jörg Guido Hülsmann (Hülsmann, 2000), ideas that we encounter in de Soto’s work also (Huerta de Soto, 2010), if we compare the banking system based on deposits with the fractional reserves based one, we observe that under the former system ownership is not transferred to the bank but still remains to the one who has the money, for example. In this case, the bank simply has to keep the deposit, to protect and return it to the depositor at any time he would ask. For time deposits the situation changes as the person is willingly transferring the ownership to the bank, for a certain period of time that is stipulated in the contract. Therefore, the bank gains the right to use the amount in its own interest, being though indebted to return on the due date the exact amount plus the accrued interest.

For a better understanding, we consider necessary a detailed explanation of the distinction between the two types of loans; we are discussing about the commodity credits, granted from time deposits and circulation credit, attributed from demand deposits. The importance of this classification is reflected by the ease with which it can be further clarified the concept of Austrian business cycle. Thus, commodity credits represent *"... transfers of savings from the hands of one who initially saved to the hands of entrepreneurs who intend to use these funds in production processes"* (Mises, 2010, p.124). It becomes easy to understand that this category of loans obtains its funding from delaying present consumption or, as formulated by Bohm-Bawerk (1889), from lowering the time preference manifested by a certain part of the population. In other words, it is precisely about the increased level of savings, the only healthy way to cover the loans granted through commodity credits. Thus, drawing attention, Mises states that *"Capital is not a gift from God or nature. His source is the individual who reduces consumption. It is generated, increased by savings and maintained by refraining from spending the saved resources"* (Mises, 1972, p.83). The volume of credit is, therefore, strictly limited

to the existing amount of savings. Banks only facilitate, through this type of loan, a transfer of purchasing power from the creditor towards the debtor; the latter accounts for the ability to acquire the necessary factors for undertaking a production process.

With respect to the circulation credit we find out that it is *"... granted from bank funds specifically designed for this purpose. When granting a loan the bank prints banknotes or opens an account for the borrower in a deposit account repayable on demand. Credit is created out of nothing. It is the equivalent of newly created fiat money, thus of direct undisguised inflation"* (Mises, 2010, p.124). Therefore, circulation credit does not get funding from the money that people have previously saved but represent, in the Austrian sense, a pure figment of banks, eager to obtain profit. The immediate effect of granting loans from this type of credit is an increase in the purchasing power of money that first gets into the possession of borrowers. Thereby, they come across the situation when they have a relative surplus of money and a relative deficiency of other goods. Likewise, these people possess monetary units, whose marginal utility has decreased, placing them in a stronger position as buyers. As a direct consequence, they will manifest their desire for particular goods in a more intense way, meaning they will be willing to offer more money in order to obtain them. We thus find out, from the Austrian economists, that the conspicuous consequence will be an augmentation in the price level of those much desired goods. By comparison, the objective exchange value of money will decline.

Therefore, the first inference that arises, by applying the first law of Gossen, namely that regarding the reduction of marginal utility and according to which *"... every need reduces its intensity as it is being satisfied"* (Popescu, 2011, p 29, apud Gossen, 1983, p.6) to the monetary theory, is that *"... the higher the stock the lower will be its marginal use "* (Wieser, 1893 p.viii). On the same line of reasoning, if the marginal use decreases in importance as the available quantity of good increases, and if precisely that importance of marginal use is what determines the marginal utility, this means that it is absolutely natural for marginal utility to decrease while available quantities increase. We have therefore our attention drawn to the fact that any augmentation in monetary units must be covered by an appropriate amount of goods, at whose acquisition participates as medium of exchange. The main consequence of the failure of this action will mark the beginning of a vicious circle in that it will cause a decrease in the marginal utility of the monetary unit, which, in turn, will lead to higher prices and, hence, on to numerous adverse consequences for economy.

Austrian economists therefore emphasize the need for apprehension of the idea according to which *"Every step toward prosperity is the result of thrift"* (Mises, 1972, p.45). This idea, initially encountered at the founder of the Austrian School, therefore at Menger (1867), and subsequently developed by the other members, highlights the need for awareness of the fact that the action of saving is, in fact, one of the pillars of a healthy economic environment without which prosperity cannot be known. Therefore, simulating the existence of funds needed to cover the loans granted to capitalists for starting economic development process is pure utopia. And that's because, according to the Austrians, through Mises, *"... what limits the amount of savings and investment is time preference"* (Mises, 1963, p.491). Consequently, when it will be realized that not changes in consumer preference (Bohm-Bawerk, 1889, Hayek 1935) are responsible for these investment turnovers but only cheap monetary policy (Mises, 1963, Huerta de Soto, 2010), the consequences will be most harmful for the proper functioning of the economic apparatus. And, sooner or later, this information will surface, assures us, in chorus, the Austrian economists.

The propagation of monetary errors within the production process

Continuing the incursion along the phenomena produced by the triggering of the Austrian business cycle, we find that borrowers are merely the capitalists eager to start production processes in hope of obtaining profit. Hence, they bid the needed production inputs with the money whose purchasing power is apparently higher due to monetary injections. An increased demand, which would not have emerged in the absence of newly created money, can be observed, resulting in a significant increase in the price level of those auctioned products. For Austrian economists the sequence in which the money enters the market reveals the emergence of a monetary asymmetry. This aspect represents an essential character for understanding the expansionist phenomenon and, from their perspective; it is the main evidence of the non-neutrality of money (Hayek, 1935).

Therefore, tracking the propagation of monetary errors throughout the production process can be easily observed with the help of the interest rate. Thus, *„Hayek's critical contrast between the*

intertemporal coordination that can be achieved by the free play of the market and the intertemporal discoordination that results from the manipulation of a key market mechanism, namely, the interest rate....” (Garrison, 2006, p.6). From this point of view, the interest rate is the price of time stemming from the loan funds offer, thus from the people who save, and the demand for loan funds, thus towards investors. Huerta de Soto finds the inspiration to state that *"... from the Austrian point of view, the interest rate represents the market price of present goods in terms of future goods"* (Huerta de Soto, 2011, p.84-85). Therefore, sacrifice requires a reward so that the amount paid to these individuals is nothing but the interest granted for the entire period of time in which their savings were used in a productive way, namely in profitable investment. If the public manifests the desire to save more, this action increases the supply of lending funds, pushing down interest rates and encouraging lending, thus investment. This theory is consistent with the ability of markets to self-regulate, by allowing the conveyance of signals on consumers time preferences. Hayek (1933, 1935) saw this process as ensuring a good intertemporal coordination as the low time preferences of depositors determine, in the first instance, a decrease in interest rates. This particular action assumes the lengthening of production processes, thus of investments exhibit in higher order capital goods.

Hence, according to the Austrian theory, any augmentation of the volume of household savings reduces present consumption, leading to a decrease in the relative price level of consumer goods, so as to: *„...the influence of money on prices and production is quite independent of the effects on the general price level. But it seems obvious as soon as one once begins to think about it that almost any change in the amount of money, whether it does influence the price level or not, must always influence relative prices”* (Hayek, 1935, p.28). Consequently, there is a higher demand for capital goods due to an increase in real wages; therefore we are discussing a lowering in consumer goods prices, namely the output obtained from the funds that have as a basis the voluntary savings of the population.

Further, there can be observed a relative increase in entrepreneurial earnings corresponding to the most remote stages of production from the final consumption. The result of the aggregation of these configurations can be translated, in hayekian terms, by an elongation of the structure of production that becomes a more capital intensive one; it is precisely due to the involvement of a higher amount of resources saved by population.

However the problem for the Austrian economists arises when exogenous factors can be detected, such as government monetary injections performed by central banks or credit injections manipulated by commercial bank agents that, without the support from the savings provided by individuals, become creators of inflation. The new money, created out of thin air, are thus provided to entrepreneurs, penetrating the economic system as seemingly real and profitable new investments, leading capitalists into building their plans based on a distorted picture of reality. Therefore, businessmen come to behave as if the rate of savings has increased considerably; however, in reality this is far from being realized (Hayek, 1935).

Thereby, newly created money floods the market, primarily, as a consequence of the lower level of interest rates, below the natural one, leaving a touch of apparent profitability to some businesses, hitherto, had no profitable prospects.

The new money, once they reached the market, determine a relative increase in the costs resulting from the placement of funds within the productive process, subsequently leading to an increase in input prices. The immediate following result is the orientation of production towards new and more capital intensive production processes.

All of this can be translated into an augmentation of demand for the resources usable within the production process, therefore a lengthening of the structure of production. Consumer goods segment records a lower level of relative revenues resulting in a cost increase tendency by comparison with the price level that records decreases. What happens, says Hayek, is a transfer of capital goods from the sectors closest to the consumption towards the most capitalistic ones.

An increased request for final goods eventually begins as a consequence of enhancing revenues collected by the owners of production factors. As their incomes rise, they will determine an increasingly higher demand for final products, which will result in a higher general price level. This rise, however, is determined, primarily, by an augmented money supply in circulation; and, moreover, the essential problem that occurs here is that the prices of capital goods used in the production of output, whose demand has progressively increased, will tend to grow faster than the latter, reaching or

even surpassing them, and thereby causing a sharp drop in investment profitability. Thus, the reallocation of capital goods that were originally assigned for longer and more productive production processes will be transferred to the stages that are closest to final goods production, with the risk that the prices invested for the purchase of such capital goods are not covered by the prices to be obtained for the final output. Over time, and without further injections through a low interest rate, entrepreneurs will be forced to declare the bankruptcy of their business. The above mentioned actions have, as a consequence, the establishment of massive unemployment and the triggering of recessions.

Conclusion

As it was well observed by Adam Smith in his primary work *Wealth of Nations*, a country's capital growth and the achieving of social progress is obtained through savings and accumulation of productive resources. He is also among the first economists who noticed the connection that is established between the development of a nation and the state of national wealth, understanding through wealth the capital accumulated through savings.

Keynes, one of the leading economic figures of the XXth century, however, believed that investing and saving are two independent decisions, unrelated to each other. The Monetarist vision recognizes the importance of interest, in opposition however to the Austrian perspective. According to the Monetarists, a low interest rate helps investors by encouraging them and marking a free path towards investment; therefore this leads to the development of a nation. By contrast, a high rate of interest will boost savings of population, which will be to the detriment of a good economic development.

From our perspective, Austrian economists succeed the closest correlation between theory and reality. They are against a reckless consumption and come to defend savings. Their approach is relevant and contains a considerable dose of truth as only through savings can clean capital be accumulated; the type that is so necessary for healthy investment. All this will lead, over time, to progress. Crises will thus be avoided.

Hence, in a healthy Austrian environment, investments are financed from loans granted by banks on the basis of funds raised from the voluntary saving of population. We are referring to time deposits, i.e. the money that people willingly and consciously give up, in exchange for the benefits obtained from interest. Thus, by granting loans created virtually from nothing, namely, without coverage in household saving funds, entrepreneurs will be provided irrelevant information on consumer preferences, leading to bad investment that will eventually prove, unprofitable.

It is therefore beyond doubt that recessions do not actually represent a market failure, as many economists believe; according to the Austrian economists these are errors caused by government intervention through the banking system. From their point of view, only a free market can react to the aggressions generated by credit expansion. The way in which it can do so is through crises that come to cure the economy of all negative repercussions left behind by the inflationary impetus. Thus, when exogenous factors such as expansionary policies interfere, economic relations are distorted, marking the path towards the triggering of imbalances.

From the Austrian point of view, a crisis will only disclose the unleashing of economy from any type of disturbing factors, thus indicating recovery through readjusting production processes to the true market structure; in other words, to the real demand of the sovereign consumer. Likewise, what must be well understood is the fact that depression does not represent the result of renouncing to the expansionist policy. On the contrary, it can be viewed as the ineluctable consequence of such a policy. The recovery process can be initiated only when the economic environment managed to remove the causes which have determined its illness in the first instance, i.e. when monetary injections are suspended.

As a corollary, what Austrian economists, starting with Menger and continuing with the ones belonging to the contemporary period, wanted to share with us is, first, the fact that a good understanding of the concept of marginal value, to which the subjectivist-individualistic methodology is added, can shed light upon the business cycle theory. Analyzing the monetary, capital and interest theories through these filters can lead to discerning, in the first phase, the micro horizon of the cycle, in order to subsequently assimilate the macroeconomic one.

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