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Why We Need a Recession

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According to the National Bureau of Economic Research (NBER), a recession is defined as [2] a "significant decline in economic activity spread across the economy, lasting more than a few months." Often, this is understood as two consecutive quarters of negative economic growth as measured by a country's GDP.

Public opinion is generally quite simple in regard to recession: upswings are generally welcomed, recessions are to be avoided. The "Austrians" are however at odds with this general consensus — we regard recessions as *healthy and necessary*. Economic downturns only correct the aberrations and excesses of a boom. The benefits of recessions include:

- Sclerotic structures in the labor market are broken up and labor costs decline.
- Productivity and competitiveness increase.
- Misallocations are corrected and unprofitable investments abandoned, written off, or liquidated.
- Government mismanagement of the economy is exposed.
- Investors and entrepreneurs who were taking too great risks suffer losses and prices adjust to reflect consumer preferences.
- Recessions also allow a restructuring of production processes.

At the end of the corrective process, the foundation for a renewed upswing is more stable and healthy. We thus see deflationary corrections as a precondition for growth in prosperity that is sustainable in the long term. Ludwig von Mises understood this when he observed [3]:

> The return to monetary stability does not generate a crisis. It only brings to light the malinvestments and other mistakes that were made under the hallucination of the illusory prosperity created by the easy money.

Can the Government Save Face?

However, in addition to leading to true temporary hardship for the malinvestment-affected areas of the economy, an economic recession in the near future would represent a harsh loss of face for central bankers. Their controversial monetary policy measures were justified as an appropriate means to nurse the economy back to health. That is, their efforts to end or avoid helpful recessions were claimed to contribute to the eagerly awaited self-sustaining recovery.

But the attempt to combat a crisis that was triggered by too loose monetary policy by the very same means will not lead to sustainable prosperity. It will only delay the crucial adjustment processes of a deflationary phase. The longer they are delayed and the more the central bankers and politicians attempt to keep them at bay, the more uncomfortable this adjustment will become.

Politics Trumps Economics

In general, there is the tendency in every democratic system to prevent too-painful adjustment processes as its nature of short-term bitterness and long-term benefits conflicts with the result scheme politicians are reelected for. No democratic government that is presented with the bill for the obvious successes and failures of its administration at the next election, will voluntarily allow a deep recession to occur — even if it were to agree that the adjustment was necessary.

Hence, inflationary policy is always a welcome method of impoverishing the population by decree and thereby pushing through a real adjustment of prices by force. The debasement of money as a rule always hits a society's most underprivileged the hardest, as rich people can more easily avoid a devaluation of their wealth.

Concern from Outside the Austrian Camp

Nonetheless, representatives of the Austrian school are no longer alone in warning about the fatal long-term consequences of the zero interest rate policy. Even the Bank for International Settlements, often referred to as the "central bank of central banks," understands that endless attempts at avoiding recessions can have truly negative effects.

The BIS's 2014 report [4] warns of overly euphoric financial markets which, according to *The Financial Times* [5] are "out of step with reality."

The BIS explains:

> Particularly for countries in the late stages of financial booms, the trade-off is now between the risk of bringing forward the downward leg of the cycle and that of suffering a bigger bust later on.

New debt serves primarily to keep the fragile edifice of debt from collapsing; it doesn't lead to new investment activity. In this respect, the BIS sees parallels between Western industrialized nations today and Japan in the 1990s. These policies, the BIS contends "destabilises the banking sector directly but also acts as a drag on the supply of credit and leads to its misallocation."

This year, the ECB, which as the successor of the German Bundesbank has long kept the flag of inflation reservation flying, finally capitulated and began betting on increased monetary stimulus — in keeping with the motto: "It isn't working, so let's do more of it!"

Nevertheless, according to F.A. Hayek, these united global crisis defense mechanisms only postpone the crisis which will take place at any rate, only later and much more severely:

> To combat a depression by a forced credit expansion, is akin to the attempt to fight an evil by its own causes; because we suffer from a misdirection of production, we want even more misdirection — an approach that necessarily leads to an even more serious crisis once the credit expansion comes to an end.

Topics:
Booms and Busts [7] The Fed [8] Money and Banks [9]
Austrian School:
Monetary Theory [10]

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Links
[1] https://mises.org/profile/ronald-peter-st%C3%B6ferle
[2] http://www.nber.org/cycles/jan2003.html
[3] https://mises.org/library/wages-unemployment-and-inflation
[4] http://www.bis.org/publ/arpdf/ar2014e.htm
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