Fact and Fiction

National and international commentators are making statements regarding the credit collapse that are wrong.

The model in which they have been trained is the J.M. Keynes – Irving Fisher model which in times of recession, recommends a greater “aggregate demand”. That is, more spending.

That is, more inflation which was caused by excessive credit expansion and hence over consumption in the first place.

But the Classical Liberal view is that the excesses of previous credit expansion should be allowed to impartially liquidate malinvestments caused by the inflation.

Only when the markets can support the remaining capital engaged in production at sustainable rates, can new capital accumulation again begin to support competitive production. Saving, not spending is the key to recovery.

The Governments of the various nations the world over are advocating ever, more “stimulating” spending while at the same time increasing regulation of the market order.

Consumption spending can only make things worse. This view is based on important facts:

1. Capital is heterogeneous and forms a production structure.

2. Money is not neutral and therefore, changes in the money supply affect the structure of relative prices.

3. The excessive credit expansion effects capital structure, which has a time dimension, forcing the rate of interest below its market rate. This sets into motion economic forces that must eventually result in a recession.

Competent commentators, and government and bureaucrats should know and understand all of this, and so better inform the public.

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