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Austrian Economic Theory of Inflation and the Business Cycle

David Rasho
Illinois Wesleyan University

Margaret Chapman, Faculty Advisor
Illinois Wesleyan University

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Poster Presentation 42

**AUSTRIAN ECONOMIC THEORY OF INFLATION
AND THE BUSINESS CYCLE**

David Rasho and Margaret Chapman*
Department of Economics, Illinois Wesleyan University

This paper intends to show that the extension of bank credit, while promoting economic growth in the short run, will eventually cause a recession or depression. Theories on inflation and business cycles proposed by Austrian economists, as well as an original extension of this theory, provide the foundation for this argument. Austrian economists maintain that bank credit holds the interest rate below its natural level, sending distorted market signals to entrepreneurs. Acting on these signals, businesses increase production and investment because more projects are now profitable. But because existing factors of production have not expanded, the economy cannot support this growth. Competition for scarce labor and capital will tighten these markets and cause their prices to rise. This unforeseen expense will force many projects to fail and an economic decline ensues as bankruptcies and abandonment wipe away these malinvestments. To end the business cycle and make possible continued economic growth, the extension of bank credit must be eliminated. Only the accumulation of capital, caused by undistorted market signals, can lead to lower interest rates and sustainable economic growth.