

Why Austrians avoid describing the economy as underperforming or overheating.

Since it is always easier to think in terms of macro, rather than micro details when explaining gross economy-wide swings in economic activity, employment etc. effects of changes in the profit and financial climate are also thought of in aggregate terms, as if a uniform change in the perceived availability of funding evenly and uniformly affects all lines of business. The result is the misimpression that the economy has periods of overheating, too much spending in general, or not enough spending in downturns. Thus the misperceived need to have government deficits (borrowing) increase current spending outlays, and the need to have more spending of newly printed dollars to stimulate the economy, even if the long run effect on prices is to raise them, it is thought that as output is falling no harm can come from a policy that simply doesn't push price up this year or the next.

On closer examination, we can see that business is in fact not uniformly affected by disturbances of the price system from outside stimulus, by easy money policies, lower interest rates and so on. We have seen that capital intensive enterprises respond more to such stimulation in being more oriented towards the future due to the nature of capital, machines, etc. as a long-term horizon investment. Less apparent are the differences that occur simply from the linkages of a complex economy where there exists not only an input-output relationship between all enterprises, but also a structure of production that, as we have described is not only horizontal but also vertical.

If we admit that the real economy is somewhere in between these two descriptions we must admit of some non-uniformity of linkages. The idea of stages of production can be found to apply widely throughout the economy. If we then encourage expansion in one business or stage, that has the effect of providing more output to the next stage towards the consumer, and thus lower supply prices in that direction, while raising prices for the inputs coming from the other direction (i.e. from suppliers to the stage in question in response to increased demand), so that to the extent the economy has staginess it responds unevenly.

This can be seen by analogy in the case where one decides to shorten each rise in a set of stairs from 9 inches to 8 inches. Here we find that the movement of the highest stair, the staircase coming down to a fixed ground level from above is more than the middle stair while the movement of the lowest stair is very little, while also an extra stair is added in a stair case of eight steps to make a ninth step, the highest step being lowered enough for the extra step. While the staircase is adjusted to reach the same elevation it has been stretched horizontally. Similarly we have dimensional rather than uniform changes in the economy. When adjusting back to the original sizing of steps, we thus have much more to do than simply resizing each step due to the cumulative distortion in the whole staircase. This was a major point made by Hayek in *Prices and Production*.