The Mises-Minsky Theory of Business Cycle

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Abstract

Mainstream theories usually explain business cycles as a problem of exogenous shocks. This approach, however, ignores the distortions taking place during the boom phase of the business cycle, thus providing at best exogenous descriptions of the business cycle. Endogenous expositions of the business cycle must trace the crisis and recessions phases of the business cycle to unsustainabilities of the boom phase. Moreover, Real business cycle and New Keynesian theories concentrate on technology shocks and price stickiness to explain the business cycle, while neglecting the link between real sectorial and financial market distortions. Nevertheless, Hyman Minsky and Ludwig von Mises provided full-fledged endogenous business cycle theories emphasizing the two neglected aspects of business cycles, financial and real sectorial. The present paper aims at providing an endogenous business cycle theory based on a synthesis of these two complementary approaches, which moreover can integrate entrepreneurial decision-making. Entrepreneurs are dragged to the business cycle because of broad money expansions by commercial banks. Although at first entrepreneurial projects are based on the real structure of purchasing power distribution in the economy, which reflects the harmonic coordination between savings and consumption. This distribution is distorted following injections of scriptural financial capital, which enable further investment expansion in detriment of the aforementioned coordination between savings and consumption. The distortions following these injections entail the passage from financially hedge projects to speculative projects. As broad money expansion accelerates, the coordination between real savings and consumption is broken, as both investment and consumption grow at the same time. Eventually, it becomes impossible for the real structure of production to follow the consumption pressures, and the financial structure of the economy crashes down as cash flow generation becomes longer relative to the present liabilities of enterprises. This is reflected in the passage from speculative to Ponzi investment projects. This synthesis provides a complete exposition of business cycles from the emergence of an unsustainable boom phase to its degeneration into crisis and recession.

Key Words: business cycle, entrepreneurship, malinvestment, sectorial analysis, speculation

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References


