CONCEPT: OVERVIEW OF THE AUSTRIAN MODEL

● The ***Austrian model of economics*** was an early model that supported a free market system over government planning

□ Developed by Carl Menger and Friedrich von Hayek over the period of a few decades from 1890-1930

□ In the 1930s, von Hayek developed the theory of the business cycle

> When central banks lower interest rates, firm investment increases, leading to increased production

> The economic expansion that follows is unsustainable, leading to a recession

> The lower the interest rates go, the deeper the recession

□ The publication of Keynes' *General Theory* in 1936 drove interest away from the Austrian model

□ However, the Great Recession of 2007-2009 fit the model well:

> The Fed lowered rates to fight the 2001 recession, leading to increased firm investment and output

- In this case, the surge in spending was in new housing, rather than factories

> The excessive investment in housing ended with a bubble and the Great Recession