

## Epistemological Imperfections of Transformational Processes in Transitive Countries

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*Abstract:*

From the epistemological point of view policymakers in transitional economies operated in the severely distorted information environment. Neither theorists or decision makers paid attention to the problem of economic calculation that was an integral part of a centrally planned economy and its immediate institutional followers in transition. Interventionists (political and government employees) made investment, production and redistribution decisions based on their subjective judgment and preferences trying to perform cyclical or countercyclical policy. Their knowledge of the business cycle as superficial and not based on a solid scientific base. In fact they considerable increased transformation costs and built fragile institutions prone to recurrent crises. Theorists of transition failed to single out the subject of economic actions – *homo agens*. Erroneously *homo oeconomicus* was taken as a doer and he was put in the frameworks of equilibrium models. Aggregate indicators of these models distorted the reality of actual discovery process by acting individuals even further. Macroeconomic approach to the analysis of transitional phenomena could not provide the information and insights that Austrian school of economics based on methodological subjectivism could. Interventionists focused their attention of neutralizing so-called market failures instead of emphasizing government failures and severe economic, social and institutional costs of state intervention. Interventionists created the whole vocabulary to justify their actions and outcomes. Vague concepts like social welfare or well-being, sustainable development, national interests were used to restrain political and economic competition, accountability of all cost and benefit outcomes in the SWOT analysis. The inclusion of theoretical achievements of Austrian school of economics into the analysis of transformation processes considerably broadens and deepens our understanding of both human actions in transformation and their outcomes.

Transformation processes in post-socialist countries of Central, Eastern Europe and Central Asia are the object of scientific analysis in many countries. They are complex and multi-faceted. In this work I will examine the epistemological problems of transfer from centralized planned economy to the system of a free market from the theory of Austrian Economic School. This approach is different from the analysis based on the neoclassical synthesis or econometric modeling as the methodology of humanities is different from the natural sciences methodology. Using the right economic science methodology gives completely different results. They are valid both for policymakers and economic subjects. The results of analysis of system transformations using the approaches of methodological subjectivism are different from analysis of static hypothetically equal statements with the help of aggregate statements and models in which the certain decisionmakers' and economic subjects' actions are not considered and the individual goal-setting is reduced to an average materialistic interpretation of the concepts of “benefit” and “welfare”.

The systemic reforms epistemology supposes determining, receiving and using objective scientifically valid information and knowledge for the diagnostic of the state of significant for policymakers and decisionmakers parameters of economic and institutional field. First of all it is

necessary to diagnose correctly the old system, which found itself in the state of deep crisis. The crisis became a reason for searching the paradigms of systemic transformation. We speak about the systemic transformation, because only small, cosmetic corrections of old institutes and mechanisms of interaction and coordination of economic subjects' and policymakers' actions were impossible.

The system transformation should start with the correct diagnosis of the state of an old system, correct definition of its parameters and cause-and-effect relationships, sources of crisis, its net beneficiaries, net payers and incentives of the main economic actors including public administrations.

The necessary element of the complex schedule of system transformation is the determination of the quantity and quality parameters of the target system the policymakers are planning to create. Then the reformers should not only create an action plan for public administrations, but convert it into laws, decrees, regulations, procedural instructions, etc. A special task on this step is to coordinate tens governmental bodies and thousands policymakers. Formation of some kind of hypothetic headquarters aimed to coordinate the reformers' actions can be suggested as an ideal scheme. In this case the expenses of the coordination deficit of numerous organizations and governance structures can be minimized. The complexity and multi-level nature of tasks don't allow us to expect the unambiguous interpretation and consistent decisions from decisionmakers on the transformation of old institutes, organizations and mechanisms of centralized planned economy to market economy. In this situation we don't speak about subjective qualities and the level of training of politicians, officials and analytics who prepare the decisions. We speak about the theoretical problem of receiving the information, its processing and coordination in conditions of significant epistemological distortion.

### **1. The Absence of Objective Basis for Formation of Market Prices**

One of the objective parameters of informational environment was the absence of private ownership on all factors of production. This state meant that in the centralized planned economy the prices as a market phenomenon could not objectively exist. The quantitative indicators the rate of which was established by the governmental bodies based on factors and parameters which were not connected or indirectly connected to real value and consumer preferences of economic actors. With such an epistemological nature of price in the frameworks of centralized planned economy we can say that instead of the price in the economy were common units and calculations. Its dynamics depended on non-economic or, more correctly, predominantly non-economic factors.

In the market economy based on a private ownership free prices are the informative indicators for economic actors. They represent the results of their actions and choice. They reflect their subjective preferences, which are the manifestations of achieving of the target sets on maximizing the utility of within the frameworks of existing information field and institutes. Free market prices is a must for full-scale market relationships and objective information field. Any interventions of state powers to the prices of factors of production, including money, distort the most valuable thing in the market economy – system of coordination of all market actors. This coordination is implemented through the mechanism of free prices. This is a fundamental difference from the centralized planning system, which deals with not the prices itself but their substitutes, i. e. the quantitative indicators chosen by the economic actors. I call them the managers of borrowed, highlighting, first of all the relation of these managers to assets and property and secondly paying the attention to the incitement of saving and maximizing value both for themselves and for principal, i.e. the citizens.

The managers of foreign are the decisionmakers, politicians and officials, which take political and economic decisions not within the frameworks of their private property, but while distributing and administrating the public finances, state assets and national property. The part of national property in the centralized planned economy was up to 100%. In such systems all prices

are distorted and this leads to huge distortions while allocating the resources, i. e. making investment, consumer and other decisions.

At any given time the prices are the numeric expression of real consumer's and producer's preferences, i. e. supply and demand. We should note, that this choice is a result of analysis of the data of the past. It is dotted and is connected only to a particular moment of the past.

The price is definitely a fact of the economic history. After a certain choice the economic actor continues making other choices many of which are of non-economic character. He analyses the information *ex ante* (before the action) and takes into consideration his expectations. After a choice the information *ex post* is also included in this volume. This information is an aggregate estimation of a number of parameters and phenomena. They include the subjective estimation of a goal, chosen means, personal satisfaction of achievement/failure in reaching the goals and reviewing the goals and the means for near and distant future.

The methodology of Austrian School of Economy<sup>1</sup> explains the formation of the market price through the actions of an individual within the framework of his private property. This approach is in the fundament of methodological individualism. According to this methodology prices and other market phenomena are the result of values, preferences and subjective estimations of individuals. The price of a loaf of bread, a computer or a haircut does not depend on 1) "utility" of these categories of goods, 2) value of stock balance (the interpretation of the classical economical school) – it depends on the satisfaction which a man hopes to get from a definite amount of goods or services at a certain time. So, the market price depends on an expected marginal utility for a certain man. K. Menger said that: "The value of every amount of goods is equal to its importance in satisfaction of different human wishes" [9]. Later in the book *The Money and Credit Theory* [12] L. von Mises integrated the theory of a marginal utility and the money theory. The necessary condition of a free price is the absence of a price control and the private nature of money based on a metal standard. Only in this case the price of money is an objective informational indicator, which fulfills its coordinating function. In the case of monopoly of money production and the refusal from their commodity (golden, silver) base of a price of money are established by the managers of foreign (politicians and officials) and reflect not the balance of preferences, values and tastes of *homo agens* (an acting human), but the values and interests of only a few people.

## **2. A Methodological Mistake: the Substitution of *Homo Agens* with *Homo Oeconomicus***

A principal difference between the neoclassical and Austrian schools of economy is the attitude to the actor, i. e. a person who commits an act. Classics and neoclassic describe the actor as a *homo oeconomicus*. It is a person, who is led by only economical, financial motives, i.e. the maximization of a benefit in money terms. For Austrian school of economy the main actor of the economic theory is a *homo agens*, i.e. an acting man. He acts for the purpose of satisfaction of his different needs, not only financial needs. Such person acts in the unique informational field, possesses the unique hierarchy of values and prices. The choice of means for achieving his subjective goals is also unique. As long as the concept of a "marginal utility" of goods or services for a certain man objectively has not got a numerical unit and a person acts in the same way both reaching his financial (expressed in monetary units) and non-financial (those, which can't be expressed in monetary units) needs (friendship, reputation, love, self-respect, joy, etc.), the *homo agens* is a natural, objectively existing object. And *homo oeconomicus* is only an artificial object, which does not exist in real life.

The fundamental mistake of the German school of economy, American institutionalism and the varieties of Keynesianism – and these very theories were chosen as a basis for developing of systemic transformation programs – was an interpretation of the economy on the assumption of an ideal human (*homo oeconomicus*) behaviour. These doctrines deal with not a real person but with some kind of hypothetical, ideal subject. He is led by exceptionally "economic" motivations, i.e. a wish to "maximize" the benefit. Such phantom does not exist in real life. History deals with unique,

one-of a kind events. A historic event cannot be described without mentioning people, places and dates. The fact that a professor conducted a chemical experiment in his laboratory on May 31, 2012 is a certification of a historic event. Any chemist can check the data of the experiment. He takes only the data connected with his experiment. He transforms a historic event to an empiric fact of natural science. In spite of their unique character all historical events have one in common – they all are the examples of human activity.

Austrian school of economy makes a clear distinction between Economic history and Economics. This school of economic research believes that economic statistics are the reflection of people's action at a definite moment of the past. In their opinion Economics is a universal science, which use logic, sense and methodological individualism for analysis of any human action at any place and any time.

The substitution of homo agens with homo oeconomicus leads to glaring mistakes both in theoretical analysis and economic policy. Economics aimed at describing our real life, searching for objective cause-and-effect relationships, cleaned from subjective estimations and statements. If the object of Economics is homo oeconomicus, which is only an artificial creature, the description of will be fragmentary and incorrect. All mistakes of this approach are particularly evident when we speak about such concepts as "optimization", "efficiency", "social balance" or "improving the welfare of the country".

The definition of an "optimum" or establishment of an optimal way of economic resources definition in the situation when the science describes a really acting man homo agens is possible in the system, when every actor can (if he is not forbidden to do it by law or there is no additional costs for his subjective goals) set his goals, choose the means to achieve them and estimate the result by himself. Moreover, the concept of an "optimum", "effective distribution" refers only to an acting man (homo agens), not to the group of people, companies, sectors or the economic system on the whole. This conclusion is based on subjective, marginal nature of a value. Only a man and only ex post can estimate whether he has achieved his goal and were the chosen means effective or not. But even having such information he cannot say whether he has achieved an optimum or the expected balance. To answer this question he needs to compare the achieved result with the alternative usage of means and resources to achieve another goal. But such experiment is not possible in real life. The experimental method can be used only in natural sciences. Life cannot be reversed. While in Physics and Mathematics we use impersonal, inanimate symbols, here we know real cause-and-effect relations. And the reason of changes is homo agens. His substitution with homo oeconomicus is a major violation of laws of economic science methodology, such as the substitution of methodological individualism with the natural sciences methodology.

While estimating the state of economy at the very beginning of systemic transformation and the development of systemic reforms program economists and policymakers considered the man homo oeconomicus, not homo agens. They wanted to optimize the distribution of national economy, carrying out the substitution of goals, individual statements and preferences. The representatives of neo-classic school carried out the substitution of the goal-setting subject, that, in the context of huge distortions of all forms of capital (land, money, goods, labor force) and the absence of objective price indicators (in view of an absence of private property) increased rapidly not only the additional costs of systemic transformations, but also the number of mistakes.

### **3. Epistemological Imperfections of Aggregate Indexes**

Finances is a special topic in transformation processes. For the analysis of finances phenomena the Austrian school followers use the principles of methodological subjectivism and individualism.<sup>2</sup> The value of money as all other goods is determined by their marginal utility for acting subjects (homo agens).The state monopoly on money, severe regulation of the price of money and active interventionism on the money and financial markets is a huge source of price information distortion for making decisions in economy on the whole by the economic operators.

Without the reconstruction of market mechanisms on the money market, without returning to the goods standard money remains the factor of permanent informational asymmetry. One of the reason of high additional costs of the transformation processes in emerging economies was an almost total absence of theoretical discussion on a monetary theory and nature of business-cycles.

The followers of Keynesian and Monetary schools discuss the money from the position of aggregate indexes, which are the derivatives of theories not connected with the money marginal utility theory. In such analysis the main indexes are “general level of prices”, “nominal wages” and “the Central Bank discount rate”. J. Keynes and his contemporary followers do not pay attention to relative prices. F. von Hayek estimated the aggregate approach form money analysis:

If... the monetary theory still tries to reveal a causal relationship between the aggregate indexes and general averaged indexes, it means, that the monetary theory hangs behind the development of the economy in general. Aggregate indexes and averaged amounts do not influence each other. To reveal their cause-and-effect relationship is impossible, but such relations can be between individual phenomena, individual prices, etc. [4].

The microeconomic approach of Mises – Hayek, which reflects the essence of their methodological individualism, is totally different from J. Keynes’ point of view. This fundamental difference became a source of discussions about the utility of statistical analysis in social sciences on the whole. The problem of validity of the initial data, which is included into difficult calculation formulae has an epistemological nature. People, who often use such calculations, put forward different theories and do not refuse of them even if their opponents provide empirical evidence of their falsity. Such situation was, for example with the revealing of cause-and-effect relationships in so-called Phillips curve.

Austrian school followers are critical to econometric models and predictions based on them. Their main imperfection has an epistemological nature. Performing mathematical operations with the data, which does not reflect real life is equal to the alchemists’ actions on the production of gold or the philosophers’ stone.

Modern econometric models assume some static structure of individual actions or some kind of a given, from the analysts’ point of view, paradigm of changes. If the nature of individual relations and the essence of preferences change, the predictions based on such models automatically become false. It is definite, that in real life, which should be studied and described by Economics only changes are permanent. Preferences and tastes of homo ages change. And they are the reasons of changes in the economy on the whole. This causality is absent or simplified in formulae and econometric models. F. Von Hayek doubted the validity of macro economical analysis on the whole [2].

In 1950<sup>th</sup> there was an intensive methodological argument between the representatives of Austrian and Keynesian schools. The followers of macro economical analysis, i.e. the active usage of aggregate values and natural sciences tools, were for the active usage of statistical analysis on purpose of building a more faithful world, where the principles of equality and humanism realize successfully. They thought that with the help of econometrics humanities would become more exact. The result of such pseudoscientific methodological mix of Keynesianism and Mathematics was the updated theory of state interventionism. Extensive centralized planning based on the conclusions and recommendations of econometric models led to misallocation of resources and, accordingly, to investment mistakes. Other negative consequences were the following: the capture of administration bodies by beneficiary lobbyists of budget programs, corruption, expansion of the non-market monopolistic relations and loss of human rights and freedoms. F. von Hayek said that “the peculiarity of social sciences phenomena is in that the empiric testing is almost impossible, because the characteristics of all individuals, which generate an economic order are too difficult and cannot be described with the help of statistics” [15]. This conclusion is equally related to mainstream macroeconomic indexes (GDP, aggregate demand, national savings) and to the index of welfare estimation, suggested by the UN and OECD. Sociological studies, expert assessments

and indexes or rates based on them do not have anything in common with the estimation of value of the acting man.

Austrian school analyses social aggregates (national economy) as a product, a result of human activity. K. Menger described such approach to social phenomena: a “national economy” phenomenon is not a direct indication to life of the nation or a direct result of the “economic nation” activity. It is a result of a great amount of economic actions of certain people in a nation, that is why they cannot be studied within the frameworks of economic theory from the point of view of the indicated fiction. The “national economy” phenomenon should be theoretically studied and interpreted as a result of individual economic efforts” [9].

After the Soviet Union collapse and elimination of socialist totalitarian system in Europe and Central Asia in the scientific mainstream discourse there was not the only epistemological topic dominated in scientific disputes of Austrian and neoclassical schools. We speak about the problem of economic calculation, i.e. the presence of the objective epistemological foundations for prices as valid market indicators, which coordinate the homo agens. The attempts of modification of the aggregate estimative indicators of the economic policy results, which ignore this fundamental problem, are not a development of the economics, they are only the modifications of pseudoscientific accounting. Only return to methodological individualism in economic theory allows us to get valid epistemological data, necessary for economic policy development in a transitive country.

With the point of view of methodological subjectivism social scientific explanations should start from the analysis of subjective mental states of studied homo agens. The explanation of human activity out of context of human perception and plans is incorrect.

The objectives of the opponents from Keynesian or other economic schools against using the Austrian methodology were amounted to false thesis that people live as atoms - separately from each other. L. von Mises denies this accusation, insisting on methodological individualism validity for the economic analysis:

The main part of human daily actions is routine... A person does many things, because he was taught to do them in childhood, or because other people do them and it is accepted among his friends. A person getting used to do different things, developing automatic reactions. But he forms his habits, because he likes the results of them. As soon as he detects that usual work can stop him in achieving his goals, or that there is another more desirable goal, he changes his attitude... Praxeology does not deal with changing content of an action, it deals with his clear form and its category structure. The studying of social context, the environment and different human actions is a task for history [10].

The supporters of the state interventionism theory for the achieving of the social optimum and effective resource distribution on purpose to correct the “market failures” makes a lot of mistakes. First of all, they ignore the human factor and the peculiarities of objective pricing process as a market indicator. It means, they do not account many human activity axioms, such as how people respond to incentives, every man is a unique, informational and axiological system, people make choices in the conditions of incomplete, asymmetric information.

Secondly, they overestimate the harm of the so-called market failures (without monetary calculations, basing on statistics ex post and value judgments of economic actors and the managers of foreign), underestimation of informal institutes and idealization of administrative and legal state actions. Neoclassical economic schools do not account in their optimization models of enhancing the effectiveness of national public resources the risks of corruption, bribery, monopolistic practices and the capture of administration bodies by corporative lobbyists.

Thirdly, the opponents of Austrian school of economy artificially divide human activity to economic and non-economic. Using of simplified calculation methodology by taking “all things being equal questioned the validity all such calculations on the whole. The epistemological context of human actions, expressed in numbers, formulas or graphs, which claim the predictive function, is

distorting the reality and enhancing the risks of misallocation of the resources by the acting subjects.

#### 4. The Epistemology of the Economic Calculations Issues

A special field of methodological subjectivism is an economic calculation. This topic was described in details by L. von Mises in his book *The Socialism* [11], but neither policymakers, nor scientists paid any attention to this problem of organization and functioning of planned economy and interventionism at beginning of systemic transformations in Europe and Central Asia. As long as the interventionism (mixed economy, a socially oriented market economy), came to substitute the centralized planned economy in most of the countries, ignoring the problem of economic calculation became the source of many mistakes on allocation both public and private resources.

Neoclassicals and Marxists, which operated the aggregate values, said, that without private property and free prices of all factors of production they can define equal prices, i.e. change the market mechanisms and distribute the resources even more effectively in administrative regulation regime by liquidation, from the point of view of policymakers and interventionism theoreticians the so-called market failures.

This argument is based on the fact that the the public authority of central planning will have full and timely information from the market for making decisions. In real life, which should be described by the science, it is impossible. The generation, sending and processing of the information takes a lot of time. People is not a complex of software for a computer, which get a command and make a work in a second. Time and resource costs of receiving, verification and processing the information are objective and the informational asymmetry is objective too. This is a state, when every acting man (homo agens) possesses the unique information, methods and peculiarities of its processing. Informational field of every person only partly connected with other people. That is why any operation of economic exchange supposes the asymmetry. Keynesians and the representatives of other schools of economy ignore this factor together with the factor of time, necessary for information receiving and processing and making a decision based on its analysis. Such transaction costs are inherent to every catallactic exchange.<sup>3</sup> That is why the neoclassical theory of perfect competition is incorrect. It ignores the epistemological component of catallactic exchange of homo agens and imposes the subjective understanding of normal in distributing public resources or even in the world economy both to researches and policymakers. The concept of a “norm” in relation to the way, volume, character and continuity of economic activity and the choice is contrary to economics, because it colors the objective, sustainable regularities with subjective axiological statements and estimations.

From the point of view of the Austrian school of economy such approach does not reflect the nature of information and knowledge. Neoclassical economists operates the concept of “the current” clearing it from the unimportant from their point of view parametres. But such method of determination of important and significant is based not on the analysis of subjective preferences and the preferences of homo agens, but on the subjective assessments of analysts and policymakers. It is a rough methodological substitution, which destroys the scientific basis of economic analysis “The Current” is only an affirmation of subjectivism. Economists should start studying the economic processes with the acceptance of homo agens. It does not mean that the economist knows everything the acting subjects know, that is a norm in the neoclassical theory. The Austrian school followers confirm with apodictic certainty that such knowledge is not only unknown to the economist. They cannot be known. “When we admit the fact, that the main part of knowledge connected to economic coordination is subjective knowledge of definite circumstances of time and place it becomes clear, that this knowledge cannot be put into one head or in the heads of a group of people” [11], says L. von Mises.

The essence of market from the point of view of the “Austrians” is in using the subjective knowledge of homo agens through intersubjective signals in the forms of prices and “profit – loss”

mechanism. They are the unintended results of acting subjects' interaction, which form the supply and demand. Neoclassicals fail to understand the essence of the market process because of misunderstanding and distortion of the methodological subjectivism essence. V. von Hayek thinks that "the market is a process of creation and using the knowledge, which is formed from subjective mental statements of the individuals" [3]. And the expectations in economy are also subjective. This fact was described in details by another representative of Austrian school of economy, German economist Ludwig Lachmann [8].

Austrian school of economy asserts that using of natural sciences methodology is incorrect and inadequate. In the equation of utility maximization of general equilibrium theory there is no place for homo agens with his subjective knowledge, expectations and values, i.e. the cause-and-effect relation is distorted. In econometric models and equations acting subjects do not make any real choice. The subjective estimations and expectations are beyond them, they are considered irrelevant or insignificant. As a result we have mental constructs separated from real life, the authors of which pretend on high quality of their conclusions and recommendations, which are the results of their application.

The method of economy studying through a general equilibrium in economy was also adopted in the models of economy school of rational expectations. They repeat the mistakes of other neoclassicals, which use aggregate values and natural sciences methods of processing and analyzing the information.

The rational expectation school followers suppose that the acting man would use all relevant information for forming his expectations. Such approach repeats the mistakes of the "perfect competition" context, this hypothetic, unreal situation of equilibrium, in which there is an unlimited amount of sellers and customer of one goods are free to make deals and cannot influence on price level and volume of deals. A freedom of free entering and leaving the market is provided together with this. The researchers are mistaken, when they assert, that the same full information is available to all acting subject in the model of equilibrium and effective resource distribution. From the point of view of Austrian methodological subjectivism the main problem, which requires an explanation is a problem of coordination of acting subjects in conditions of real informational asymmetry and transaction costs of receiving and processing of information and making decisions. The moving process from the individualized knowledge of homo agens to market coordination is excluded in neoclassical models, including the rational expectations school models.

Austrian school of economy followers assert that using free market prices of all factors of production as an objective unit of economic calculation is an only way to neutralize the epistemological distortions and imperfections for homo agens. First of all, free market prices are formed under the influence of axiological statements of all market participants. Secondly, free market prices give an opportunity to estimate the effectiveness of resource using by all market participants. Thirdly, as long as the market provides the interchangeability of goods, there is an opportunity of choice of a universal value – the money. L. Von Mises thinks that:

in conditions of private property the scale of values is a result of every independent society member's action. Every person plays a double role in its formation – as a consumer and a producer. As a consumer he elaborates the estimation of final consumer's goods. As a producer he uses these goods so that they give the best value. So, all the high rated goods are rated according to existing production conditions and social requirements. The interaction of these two processes guarantees the observance of principle of effectiveness both in production and consuming. The result of this is a system of exact prices, which gives a possibility to everybody to form the demand taking into account the economic reality [11].

It is obvious, that while using the financial calculations it is impossible to take into account all external effects. We cannot express beauty, honor, health and self-respect in USD or Euro, but these factors affect the nature of monetary calculation during the exchange operations. This factor make



corrections in behavior of homo agens. The ignorance of them in aggregate models make epistemological distortions on the market stronger.

For making exact financial calculations two conditions are necessary. First of all it necessary to have a free market not only of final goods and services, but also of the factors of production market, including capital. Or it is impossible to make a choice among the unlimited amount of alternative ways of using goods and services. Secondly, the money, which fulfill the function of exchange means is necessary. A free market is a necessary condition for generation of objective information about the state of catallactic exchange on the market and cleaning the epistemologically valid information from the subjective statements of policymakers and the managers of foreign (politicians and officials, which are not the owners of public resources, assets and money). In case of saving the state monopoly on money (all 29 transitive countries of Asia and Central Europe acted in the same way), homo ages receive the distorted information about the most important factor of production and cannot make exact calculations in distributing their resources. As a result homo agens make many investment, production and consumer mistakes. A rather high concentration of them explains recurring recessions and economic crises. The greater amount of prices are distorted by the state, the greater volume of resources and assets are excluded from free market exchange in the system of division of labor, the higher is the probability of mistakes for homo agens in choosing the means for their subjective goals.

The attempts to solve the problem of economic calculation in the system of interventionism are justified neither theoretically nor practically. V. Pareto, E. Barone and O. Lange tried to theoretically justify the possibility of economic calculation in the market socialism model, i.e. the system without private ownership of capital goods and money. They assert that the market prices formation is possible, when the managers of foreign, first of all know the scale of preferences, that guides individual consumers, secondly, have the data on different alternatives exchange conditions and thirdly, they have the information on presence of capital goods.

Only within the frameworks of ideal, utopian model, which ignores the factor of time and transaction costs of collecting, sending and processing of information it is possible to fulfill the first condition. Without it it is impossible to receive the information on very important second factor. That's why the actions of the centralized planning body on word of mouth would be aimed at market equilibrium on different capital goods markets, but really they would help to achieve the subjective goals of homo agens, who have the access to state resources, assets and money. O. Lange thinks that by trial and error the centralised planning body would achieve more material and social success that within the frameworks of private market economy model. Results of the activity of the countries that have worked within this theoretical paradigm, together with the results of those, which have chosen the capitalistic model, i.e private property, political, civil and economic freedom, unimpeded action of "profit – loss" mechanism prove that the theorems of supporters of different interventionism forms were false. Market path of resources, goods and services "producer – consumer" was superior to the way "producer – centralized planning body – consumer", proposed by most of interventionists.

## **5. The Costs of Goal-Setting**

The methodology of Austrian school of economics rejects not only the holistic methodology to the classical school of economics, but also the historical method of German historical school. While conducting the systemic reforms in post-socialist countries of Europe and Central Asia, the methodological mix of classical methodology and German historical school was used. Decisionmakers put holistic goal of efficient distribution of resources, optimization of social welfare and sustainable economic growth, etc. In the very wording of the purpose it was assumed that the state should use the broad economic policy tools to achieve these goals. Common tools of state intervention are fixing maximum and minimum prices, credit expansion, the selection of so-called strategic enterprises, "growth points" and the delivery of budget loans on favorable terms,

exchange rate manipulation, tariff and non-tariff regulation of foreign trade, licensing procedures and the exclusion of certain economic activities and resources from the market relations of exchange, i.e. the establishment of a state monopoly. Here we speak about the so-called natural monopolies, land, production of alcohol, tobacco, drugs, weapons, as well as certain sectors of the financial market.

Holistic approach to goal setting, ignoring the nature of human activity and nature of price as an indicator of basic information for economic actors became the reasons for transformation problems in the transition economies, and institutional defects that were the result of the reforms. Austrian school of economics is based on the fact that to only human can act, i.e. can make choices in order to achieve his subjective goals, in his unique value-axiological field. The animation of the concepts of aggregate values and simple verbal metaphors of the “national economy”, “industry”, “people”, “economy”, “real economy” is a huge methodological error. They cannot set goals and to choose the means to achieve them by definition.

Decisionmakers or managers of foreign commit massive interventions to the economy under the guise of abstract goals, which they call public or governmental interests. In this case, by definition they pursue their personal goals, which are often not verbalized. Their targets include getting material resources (salaries with taxpayers' money, social benefits, pension payments, the possibility of rolling back the distribution of property, assets and money) and nonmaterial (administrative, human resources for campaigning, social status, prestige, the ability to provide a range of services, etc.).

In the centralized planned economy, there was a seizure of a formal goal-setting, on behalf of the state and society by the Communist Party. At beginning of systemic transformations this function goes to democratically elected governmental bodies (the president, the government, the parliament) or by pressure groups, who carried out a full or partial state capture. Anyway, the decisionmakers declare the most common, usually nonquantitative goals for the sake of “public welfare”, “overcoming the systemic crisis”, “economic balance” or “creation a new economic and social institutions.” Neither in the programs of political parties and movements, nor governmental programs there is no clear description of the target or guidance or instructions on using the state property, resources and assets, which are formally owned by the state. This allowed decision makers to focus on achieving their personal goals.

In condition of limited political competition, restriction of access to relevant information on the using of state property, assets and budget, transformation of power structures and vessels in the independent economic actors, who market their services, complete imbalance of pricing mechanism of economic activity coordination and significant restrictions on the action of “profit – loss” mechanism there was a redistribution and concentration of resources, assets, and money in the hands of those who were real, not formally named a beneficiary. Their rapid enrichment, creating regulatory development process and economic decision-making by these beneficiaries, widespread discriminatory practices of monopoly, corruption, poor governance, the protection of selected sectors and economic agents from the competition and responsibility (bankruptcy) is hardly synonymous to the achievement of such formal goals as “public welfare” or “balanced development of the economy,” even if at that time GDP annually increased by 5 – 10%.

The problem of formulating economic policy objectives and transformation processes is clearly underestimated by scientists and analysts. If there is no clearly defined, preferably expressed in some quantitative indicators target, it is impossible to assess whether it is achieved or not, it is impossible to assess the adequacy of application, using and selection of resources and assets with the alternative. The aggregated, holistic goal creates an unsolvable epistemological problem, not only for evaluating the effectiveness of various methods, mechanisms and tools of resource allocation, but also for the decisionmakers itself or the applicants to perform their functions.

## **6. The Difficulties in Defining the Concepts of “Prosperity”, “Wealth”, and “Points of Growth”**

The attempt to clearly define the value of a certain aggregate, metaphoric value faces the inevitable difficulties arising from the very nature of such concepts. The vague goal, varieties of its interpretation creates a broad manipulative field for policymakers. Aggregate targets have significant epistemological defect neutralization of which is not possible even in conditions of an open political competition and free civil society.

What does the words “public welfare” or “public prosperity” actually mean? By what criteria, parameters and estimates can their fulfillment be judged? How adequate was the means chosen for them? Who and how much became the beneficiary of implementation of certain economic policy measures? The answers to these questions are interpreted by policymakers themselves. The variety of answers creates conditions in which the common semantic, methodological and psychological manipulation that go beyond economics, and even economic policy.

One approach to aggregate goal-setting involves the formulation and implementation of the quantified targets: GDP growth, the level of wages and pensions, the number of people living below the poverty line, unemployment, investment (exports) per capita, etc. Each of these indicators is not able to clearly indicate the performance of, for example, the goal of public prosperity. Even an increase of common indicators such as gross domestic product (GDP) growth is not equal to public welfare growth.

The second approach is the assess of target indicator of “public prosperity growth” with the Gallup Poll and expertise. This approach is even more susceptible to manipulation. The composition of the questionnaire, the sample of experts for the survey, interpretation of results – all this do not let us to speak about the scientific validity evaluation method of achieving an aggregate goal.

In recent years a number of international organizations have attempted to introduce an indicator instead of GDP, which would reflect, in their view, the other aspects of welfare. The systemic is the report of the Organization for Economic Cooperation and Development (OECD), “How are you? Measuring the well-being” [5]. The authors try to introduce a new aggregate indicator based on research of Nobel-winning economists Joseph Stiglitz, A. Sen and J. Fitusi on economic development and social progress. If in the latter the indicators are aggregated, but quantitative, the well-being index OECD brings together the opinions, judgments, estimates and numerical targets.

The citizens’ income generated abroad is not included in the indicator of “gross domestic product”, but the income earned by foreigners in the country is included there. It does not include the value of intermediate goods used in production. GDP overestimates the amount of possible consumption of manufactured goods at a fixed capital stock. Another claim to this indicator is that it does not show how the income is distributed among people. GDP does not include a variety of services that people produce at the household level (such as caring for children and parents, child-upbringing and household work). Certain types of activities that are included in the GDP on the contrary reduce human welfare, for example, an increasing of the transport services cost: more time is needed to get to work, to offset the costs of air pollution). In GDP there is no estimation of health, personal safety and quality of social relations. They are all important for a human and affect his well-being. In this case, all these factors cannot be expressed in some monetary units.

OECD experts are aiming to bring a digital indicator by which one would rank all countries of the world to highlight the best practices and modernize the economic policy of developing countries. Thus the desire of economists and experts who carry out the substitution of the object of economic policy (homo oeconomicus instead homo agens), the target of a specific person with subjective goals of policy-makers who ignore the objective asymmetry in the information field is reflected in the simulation even more inaccurate, unscientific and manipulative indicator than GDP. They go beyond economics when trying to present the man with his values, goals and preferences as a digital value from "0" to "1".

In recent years, the attempts to present some aggregated indicator of well-being were taken by different organizations. So, the Legatum Institute in 2009 presented its LPI (Legatum prosperity index [14]). It consists of eight parameters, each of which is divided into separate 89 factors. The economy, entrepreneurship, governance, education, health, safety, personal freedom and social capital should be evaluated. OECD proposes that the well-being should be determined by 11 parameters, which are divided into 46 factors. The total index combines the indicators, the results of opinion polls and expert assessments. The authors use the tools and techniques of higher mathematics and econometric modeling are trying to identify those institutional features and mechanisms that contribute to welfare. In their view, people's answers to the question, whether they like their work and the local environment, if they have health, if they spend enough time with their children and friends, whether they trust their neighbors and whether they are satisfied with their lives and all this in a digital indicator are a better way to determine the level of well-being and, consequently, the quality of economic policy than the GDP.

OECD experts are experiment in the same vein. They have brought together all the indicators of well-being to three groups: the material conditions of life, quality of life and sustainability. The index should measure welfare today and tomorrow, to focus on households and individuals, not on aggregate economic conditions in general, focus on the results of well-being and not on its stimulants and point to the distribution of income, and not on its volume. In other words, the Index of well-being must include objective measures and subjective evaluations. Objective indicators of the OECD are income, employment, housing. Subjective indicators are health, balance between work and leisure, education and social connections, civil engagement and the quality of public administration, environmental quality, and assess of people's own well-being.

This kind of juggling with different in nature, content, and methods of obtaining data has nothing to do with economics, but it is a senseless epistemological mix, based on which it is very problematic to make scientifically substantiated corrections in economic policy. It further extends the field of policymakers' manipulation and does not provide valuable information for homo agens.

Thus, the goal-setting of policymakers during systemic transformations, expressed in multiple aggregate values, or the composite index does not allow to neutralize the epistemological imperfections in the development of content, tools and techniques of economic policy, in building a system of incentives for policymakers in assessing the performance of managers of other people's property, assets and resources (politicians and officials).

## **7. Real Market Process Against Idealistic Non-Market Equilibrium**

Another epistemological problem of transformation processes is the assessment and determination of cause-and-effect relationships in the market process on the one hand and the so-called market equilibrium on the other. The supporters of neoclassical school adhere to the concept of perfect competition and information symmetry for all market participants. L. Von Mises describes the participants of market process in a state of permanent ignorance. Such state is different from the state of ignorance by choice. The first condition implies the complete lack of knowledge of some aspects of activities that define a person's choice. You can, for example, say that someone, who did not read the L.von Mises' *Human Action*, but know about this book, its value and the time it takes to read it. A person chooses not to read, because the costs of reading outweigh the gained value (benefit) ex ante. This is a state of ignorance by choice.

Another situation is when a man does not know about the existence of this book. Accordingly, he does not imagine the benefits that he would receive if invested time and consideration in reading it. This is an example of radical ignorance. If a person discovers the "human activity", it is not the result of his conscious purposeful action. He does not know about such choice, as reading the book.

To avoid the infinite regress it is necessary to interpret the perception of costs and benefits as an act of knowing the world and obtaining the information that homo agens did not know before.

The market exchange may not occur because of the high costs of obtaining the information or because the homo agens knows nothing about the existence of such an option of choice.

The “profit-loss” mechanism is a central element of the market process. The unknown and undiscovered market opportunities generate losses and detected and corrected errors create the profit. I. Kirzner uses the term “entrepreneurship” to describe the aspects of human activity, which is aimed at making a profit and loss prevention [7].

In the context of market process the essence of entrepreneurship is to identify the situations in which, due to radical ignorance, the resources in the broadest sense are undervalued or overvalued relatively to other ways of using them. Social institutions are used to identify and promote the economic behavior that is aimed to obtain benefits in the broad (not only the material and monetary) sense. These institutions include legislation protecting the rights of ownership, determining the procedure of dispute settlement, mechanisms of implementation of the decisions of government agencies, etc. The institution of money and credit, the price system, banking, insurance and the company are important. All these institutions together form the market. The market process is a spontaneous order, supported by the institutional infrastructure, in which the private property and free exchange dominate. It arises out of independent targets of actors, who plan and choose the means to achieve their goals in conditions of an incomplete, asymmetric informational field. The managers of foreign cannot perform a unique function of businessmen, because the aggregation of goal-setting will inevitably lead to distortions in the choice of economic agents and, as a consequence, in the structure of the economy.

From the point of view of the market process theory, the utility of a regulatory structure, based on the balance, such as Pareto optimality, is severely limited. The problem of knowledge in the theory of market process is that decisionmakers are in radical ignorance of the relevant information, “scattered” among the various actors. The impossibility of complete knowledge of homo agens about current and future state of the world makes the Pareto’s assertion that the current change produces an improvement doubtful.

The criteria based on the equilibrium states use the final states in which all the corrections made on purpose to reach the equilibrium were committed and the entrepreneurial activity stopped. While for normative criterion that focuses on the process (process-based normative criterion) is not as important as the actual state differs from the ideal. It focuses on the existence of institutions that facilitate the detection of market errors. In the fundament of this criterion there are preferences of consumers and current distribution of resources in itself has no value.

In the market process theory the necessary and sufficient condition for the competition is free entry the market, the only requirement for which is absence of monopoly on those factors that are necessary for the production of goods and services. As long as the market systematically rewards the entrepreneurial perception errors, we cannot say that a certain segment of the market reaches a state of equilibrium or is close to it. If the coordination has some normative value, the best thing to do is to build such social institutions that help to detect errors and recover them with minimal costs.

In countries with developed, stable institutions the error detection is much easier, because the actors have a high degree of confidence to the institutions. They provide a predictable result, the same for all people. The standardization of concepts, the adoption of the same rules of accounting, regulatory standards of product and financial markets help homo agens quickly detect the errors. The wide spread of information technologies, the opportunity to acquire various information and check it using a variety of sources under the conditions of freedom of speech and the strict rules of the transparency of state and of the financial market make the process of correcting the error fast and efficient.

A completely different situation is in a transition economy. It does not have sustainable institutions that provide predictable results and reduce the number of areas of uncertainty and potentially high risk. In the absence of institute of a free price to all factors of production, including money, the natural structure of production and employment, with significant distortion of the

financial market (inflation, subsidies, cross-subsidies, barter, tax and investment privileges, etc.), the risk of incorrect assessment the epistemological essence of institutional combinations by the economic actors increases dramatically.

National governments in the process of systemic transformations often used their own special methods for calculating different indicators different from the standard methodology for calculation of quantitative indicators in the market economy. When copying a form of Western institutions their content differed significantly, preventing economic agents from stable expectations in connection to the institutions and rules of the game in the market. An extensive state interventionism (cyclical and counter-cyclical monetary policy, government funding of so-called “points of growth”, debt relief, including in public procurement, tax incentives, protection against competition from foreign producers (import) and domestic competitors (the system of licenses and permits) makes institutional field the source of information distortions, which creates a dangerous epistemological noise for decision-making. In these conditions, the probability of investment, production and consumption of errors increases rapidly. The unpredictability at the macro level adds to the uncertainty and destruction of the exchange mechanisms in micro-level. The managers of foreign within the frameworks of neoclassical models pursued a policy of replacing a unique, market function of the entrepreneur.

The nature and character of epistemological problems were not taken into account by governments of transition countries. And from here goes the high costs of transformation processes, including the costs of lost revenue. Nature of theoretical discussions among economic elites of post-socialist countries shows the misunderstanding of the knowledge issues, the role of the entrepreneur, the “profit – loss” mechanism and other institutions and mechanisms of the market economy.

In the absence of deep analysis of the value system, the incentives and preferences of the actors, using the aggregate indicators, econometric models to determine the trajectory of the future development and for economic policy development is an example of a chaotic, non-systemic selection of economic policy parameters. The emphasis on a hypothetical equilibrium in economic policy leads to an underestimation of constant costs, incremental changes in the intermediate states, which may have a significant impact on the achievement of the declared objectives of policy-makers.

Mainstream economic science has turned into a closed self-reproducing system that describes not real life and not acting man. In real life the process is constant and the equilibrium state is a hypothetical scholastic tool for studying the “action” phenomenon. The attempts to find effective and optimal behaviors with the help of science methodology demonstrate knowledge in mathematics, cybernetics or econometrics, but they ignore the theory of value and the market process.

The supporters of Austrian school of economics understand the market process broader than the neoclassical school representatives. The main differences are shown in Table 1.

The market equilibrium theory	The market process theory
1. There is a full coordination (reinforcing expectations) of the plans of the individual agents, when the plans are in line with the underlying preferences, technology and resources.	1. Plans, at least of some of the actors are in conflict and are not compatible with the information of the market, although a partial coordination retains a degree of continuity of the market.
2. Behavior is “rational” when all else being equal ( <i>ceteris paribus</i> ) and all information is relevant, the actors maximize utility by choosing the least-cost means of achieving their goals.	2. The action is the “purposeful” when actors seek to improve the perceived state of the world, though they are not aware of all the possible means to achieve this goal.
3. All changes are predictable, which eliminates the possibility of original error, surprise or regret.	3. Actors do not have full knowledge of the relevant information, they make mistakes, make unexpected changes, regret and wonder.
4. Economic gains and losses, being incompatible with a state of equilibrium does not exist or are very transient.	4. Persistent and recurrent economic results in the form of profit and loss are the main elements of the market process.
5. The equilibrium price dominates, which ensures the consistency of the actors’ plans and the information underlying the activity.	5. There are non-equilibrium prices that reflect a lack of coordination or discoordination. They serve as a signal for the plan of generating the revenues and market corrections.
6. When these transaction costs the market allocates the resources to achieve the most important goals.	6. The presence of error is the cause of an inefficient allocation of resources, which the market tends to correct.

**Table 1.** The discrepancies between the market equilibrium theory and the market process theory

## 8. Epistemological Imperfections of Neoclassical Theory of Business Cycles

The discrepancy between Austrian and neoclassical economics is in choosing the tools, the methodology and logic on the one hand and policy advice on the other are very evidently seen in relation to business cycles. The representatives of Austrian School of Economics, first of all, Ludwig von Mises and Friedrich von Hayek had the unique theory of business or trade cycle. They establish a clear cause-and-effect relationships between the state interventionism and fluctuations in economic activity. Ludwig von Mises in a popular manner outlined the essence of the business cycle theory. The architect has many subordinated workers. There are a lot of materials on building: bricks, roofing, glass, beams, blocks, etc. The worker who is responsible for counting the bricks increases their number by 10% in the documents. The architect does not know and makes the house plan, mistakenly believing that he has more bricks than it actually is. And because of this error he launches a plan that cannot be realized until the end for the simple reason that there is not enough bricks for completing the construction. The faster the architect will detect an error, the better. If he does so immediately after the excavator dug a hole for the foundation, the loss will be only in the form of additional labor and fuel to reduce the foundation area and adapt it to the actual number of existing bricks.

The correction of an error is more expensive if it is discovered after the production of foundation or frame home. And he may not be able to buy the materials on the market – he has to make a difficult choice. He may choose not to change the foundation, despite the fact that it is bigger than it was planned. He needs to alter the plan to reduce the size of the house on the same foundation. He needs to change the plan to reduce the size of the house on the same foundation. A certain amount of wood can be used again and something you should be just thrown it away or burnt down. Of course, the quality of the finished house will not be so high as it was originally

conceived by the architect not knowing the real number of bricks and other building materials. Let us consider the following situation. The workers realize that they have made a mistake, but the architect of this still does not know about it. They decide to keep him in the dark as long as possible, using a tarp to cover the holes in the underlying stock bricks. They comfort themselves with the fact that all are happy at the construction site, everyone wants to come to work every morning and build a house. Since the architect learns about the lack of bricks, optimism is much less. At this stage of construction, for example, only three workers are necessary to build the third floor, but on the basis of the actual number of bricks, this third floor may not be built at all. The workers therefore prefer to hide the truth as long as possible, to do nothing and wait for better times.

In this example, the error of the architect – is an example of not overinvestment, but the bad malinvestment of the resources. The problem is the number of bricks, that is necessary to build a house. The mistake is that the builder has spent too many bricks to build the first floor. With each brick in the wall of the house there are less options for saving the project. In the worst case the architect learns about the lack of bricks at the very moment the last brick is used. Facing with such terrible situation, the architect can only make an inventory of the remaining materials in the hope that he can probably find enough things to close the construction site from rain or to conserve it.

This is a graphic description of the Austrian business cycle theory. In the real economy the central bank and commercial bank money is misleading economic actors in the same way as the workers have misled the architect. The correction of errors at early stages of the project allows to perform the fast reallocation of resources, including labor, and to avoid loss of those goods and resources that can be used only for the project, which should be closed or liquidated.

The principal difference between Austrian and neoclassical schools is in that the neoclassical and, above all, Keynesians do rough assumption of capital homogeneity. Capital can appear in various forms in real life. Part of it can not only be “frozen” for an indefinite period, but turned into a “dead” capital recycling or destruction of which requires additional resources. The reason of an economic boom (the first part of business cycle) is the active cyclic policy of the central bank and the government on increasing the access of economic agents to certain types of capital (money, land, real estate, etc.). The managers of foreign try to guess the structure of the economy and future demand and take measures on correcting the so-called market failures. One of them is a very high price of debt capital. And from here goes the most popular tool of cyclical policy – reducing the value of money and artificial reducing of credit.

At the stage of falling which is characterized by stagnation and recession the managers of foreign use countercyclical measures. They activate the tools that allow economic agents to get out of the liquidity trap, service current debt obligations as well as to restore the production level. Selecting the areas of investment, the beneficiaries of budgetary resources and various state programs are implemented according to subjective assessments of managers of foreign. It is a paradox, but the action of cyclical and countercyclical policies are very similar. This is exactly the case when the same instruments of state interventionism are used first of all to create a problem during the boom (distortion of capital structure, employment, business and consumer preferences), and during the fall – to address it through the redistribution of resources in favor to the designated “point of growth”.

Neoclassical economists underestimate the costs and the negative impact of central banks activity in the cyclical and counter-cyclical policy. The representative of monetarist school Milton Friedman believed that the cause of financial instability is a reactive policy of central banks, i.e., their counter-cyclical policy. In his view, to eliminate fluctuations it is enough for the central bank to increase the money supply at a fixed amount. In 1968, he said:

I would choose the following policy. It is necessary to pass a law that gives clear guidance to the monetary authorities to increase the amount of money for a certain amount. For this purpose I would define money as currency in circulation, including the money out of commercial banks plus all deposits of commercial banks. I would clearly give the instructions to the Federal Reserve, that the amount of money should



be increased every month, if possible, every day, with the annual growth rate of X percent, within 3 – 5 percent. A clear definition of money and precise definition of growth are much less important than the final choice of defining and determining the rate of growth [1].

This approach to monetary policy for smoothing the business cycle shows that the monetarists have no solutions to the problem of distortion of capital within the business cycle. Their simplifications in considering the markets of goods and money distort the real heterogeneous nature of money and goods.

Another representative of neoclassicals Paul Krugman also shows the misunderstanding of the Austrian business cycle theory. He describes the paradox of savings while overcoming the crisis:

One of the most interesting moments of the semester is when the teacher of economy explains how an individual virtue can become a public vice, how the attempts of consumers to make the right additional savings can spoil everything. The fact is that if the consumers cut their expenses and nothing replaces their place, the economy plunge into a recession, reducing the income of everyone. In fact consumers' income may be reduced more than their expenses. Their attempt to save more money turns to such situation. This feature is called the paradox of savings [6].

The paradox of savings, the Phillips curve, the paradox of value – all these are theoretical errors arising from the using of non-scientific methodology for economic analysis. Following the recommendations of P. Krugman and other Keynesians does not neutralize the distortion of the structure of capital, production and employment, but just generate new distortions. During the financial crisis, demand for countercyclical monetary and fiscal policy increases rapidly. The expert Martin Wolf, who declares his commitment to the free market wrote in the Financial Times: “In current situation, the monetary policy measures are not enough. This Keynesian situation requires Keynesian medicine. Budget deficits will rise to not previously imaginable levels. Let it be so” [13]. This kind of approach to economic policy dominates in the mainstream of both developed and developing countries, despite the obvious crisis of the Keynesian policy of the last decades.

At his time, K. Marx offered a centralized credit in the state banks by providing monopoly to the national bank. Later the theoreticians of market socialism, Oscar Lange, Abba Lerner, H.D. Dickinson proposed the governmental control of credit and financial capital. In their theory the market trade and the using of money for the purchase of consumer goods was assumed. However, they offered to drive the market of capital goods, and completely replace the financial capital markets with the mechanisms of central planning.

The market socialist theoreticians believed that the investment in fixed assets should be determined by the state officials and not competing with each other with the help of structures in financial market. The public officials need to determine the rate of capital accumulation and other investment activity options, including the investment sphere. Thus, they proposed to neutralize the greed for profit-oriented capitalists and entrepreneurs.

The convincing proof of the fact, that even in the United States today there is lack of not only a laissez faire capitalism, but even the undistorted capital market is the following fact:

There are 15 federal agencies in America. Nine of them intervene in the housing market, transport, health, education, energy, mining, agriculture, labor and trade. All of them in their usual manner invade in different aspects of human economic freedom. In the system of laissez-faire capitalism, eleven of the fifteen ministries would be disbanded. Only the Department of Justice, Defense, Interior and Finance would remain. Moreover, a further reduction of the state officials would also be possible, for example, the elimination of the Tax Service in the Ministry of Finance and the Antimonopoly Committee of the Ministry of Justice [17].

The representatives of Austrian School of Economics, do not share the views of neo-classical school, that the business cycle is an integral feature of capitalism. They assert that the business

cycle is an unintended consequence of government interventionism to monetary policy and banking. At the beginning of the century viewpoint was presented by the Ukrainian economist M. Tugan-Baranovsky: He believes that the main reason of the crisis is

the distribution of production is disproportionate: the society requires less machines, tools, iron, brick and wood than before due to the fact that there are fewer new enterprises. But as manufacturers of capital goods can not extract capital from their businesses and also the awkwardness of that capital itself in the form of buildings, machinery, etc., requires the continuation of production (otherwise entrepreneurs would lose percent on the standing capital) therefore the overproduction of capital goods is imminent [16].

There are strong structural distortions at the market and changes in the capital structure in such situation. The supporters of the state interventionism theory believe that the state will be able to neutralize these distortions and ensure sustainable economic growth using tools of monetary, fiscal and administrative policies. However, they do not explain the nature of mechanisms, methods and tools for the diagnosis of distortions in the markets of all forms of capital, determining the degree of distortion, defining specific “portions” of impact on all sorts of distortions. There is also no analysis of the costs of lost profits, the effects of crowding out private entities from the market because of discriminatory practices. Without completing the clearing operations it is impossible to determine how much capital in which sectors requires the elimination of which can be put into circulation after some modification, and which can simply be directed to other projects. There is no clearly defined timing of countercyclical measures, the execution test, and evaluation system of effectiveness of different instruments.

In real life the adaptation to crisis, i.e. the step of business cycle fall is uneven for different economic actors in different sectors. The duration of an adaptation time depends on many endogenous and exogenous factors. The direction of their activity, the content and the intensity can not be expressed in numbers. The policy-makers, who, following the recommendations of neoclassical theoreticians use the tools of monetary and fiscal policy to neutralize their own mistakes cannot have such calculations. Without them the decisionmakers’ actions occur in the epistemological chaos. It is characterized not only by the common lack of valid information from the micro level, but also completely distorted signals from the macro level, i.e., from the institutions of a market economy.

Without governmental interventionism cleansing the economy from the effects of boom takes a time depending on the number and depth of distortions. The “profit – loss” mechanism work changes the capital structure, investment and employment. The entrepreneurs form their expectations after analyzing the information ex post taking into account the individual projections of the micro-level data dynamics and institutions. The coordination of homo agens actions occurs smoothly and gradually, through trials and errors. And its driver is not the governmental body of central planning, but the entrepreneurs who implement the catallactic exchange with each other. When not having any valid information from the market the best behavior for the state is to withdraw their investment, production and consumption projects, to ensure reliable work of the institutions on clearing the errors committed at the boom stage (bankruptcy, the stabilization of prices, the elimination of budget deficit, the projected debt management), as well as forming trust to whole economic policy, i.e., to its transformation into a predictable valid epistemological context.

According to the Austrian theory of the business cycle during artificially induced boom allocation of labor and other forms of capital investment projects that do not meet the level of real savings occurs. At the boom stage the correction of economic plans is inevitable. The implementation of artificially overestimated projects terminates even before their completion or fulfilling the planned targets (payback or return). The entrepreneurs get information about the errors during the boom and take steps to neutralize the negative effects of capital misallocation. The consumption is reducing. The number of the poor is increasing. All these negative effects are the result of not the correcting actions of entrepreneurs, but the cyclical policy of the central bank and

the government during the boom. It produces errors in economic entities' actions. The financial bubble (irrational investment and consumption) has a negative impact on the economy. Sooner or later, the boom ends with slump and recession. It means a painful but necessary adaptation to the reality. In the process of adaptation there is a transformation of production and capital structure, which had been distorted during the boom. If during a recession the managers of foreign use monetary and fiscal measures to keep the old structure of capital, they further increase the amount of "dead" capital and costs of the recession overcoming.

In this situation,

a key element of economic policy is the liberalization of the economy at all levels, especially in the labor market. It is necessary to accelerate the process of redistribution of production factors, and primarily the labor in the lucrative sectors. At the same time it is necessary to reduce the governmental expenses and taxes in order to increase the income of economic actors struggling with debts, who need to pay loans and percent. An important element of crisis overcoming is a flexible labor market and strict policy of public expenses. The quick restoration of the economy is impossible without it. There is no possibility to quickly find the amount of the incorrectly invested capital and thus begin the process of its liquidation and building a new foundation [18]

says the Professor of Economics, University of Rey Juan Jesús Huerta de Soto, a representative of the third wave of Austrian school of economics. During the inevitable recession the resources are reallocated, the economy is cleared from malinvestments committed during the boom. Therefore, this process certainly has a positive character. The process of finding the entrepreneurs' mistakes committed during the boom starts. For various reasons, including the increasing information distortions caused by the cyclical activity of the state, their limited resources did not go to those projects that would be implemented if not the artificial credit boom.

The first global crisis in the XXI century in 2007 – 2009, as the Great Depression<sup>4</sup>, as tens of crises around the world in different periods of the twentieth century [21] is the result of monetary policy, fiscal stimulation of artificially selected "points of growth" and the highlighting of individual economic agents and even sectors in general conditions of the market, which is directly connected to the discrimination against other economic actors. In any transition country the state monopoly on money was not eliminated, which did not allow the economy to eliminate the most dangerous distortion in the money market. If these root causes of the crisis are not eliminated, the national and global economy will periodically fall into recessions and depressions and policymakers within the frameworks of the neoclassical theory will continue using different combinations of cyclical and counter-cyclical measures. From the epistemological point of view, they are the distortion tools of natural structure of capital, production and employment.

For sustainable economic growth, creating opportunities for long periods of prosperity and peace, neutralizing the problems of structural unemployment, depressed areas, creating effective mechanisms of insurance against falling into the trap of poverty in old age require a deep transformation of economic policy. The matrix of the neoclassical economics as the foundation of economic policy should be replaced with the theory of the Austrian school of economics. Changing the theoretical framework of transformation processes will eliminate the epistemological distortions created by policy-makers, modify the institutions established within the framework of state interventionism, and go to the natural structure of capital, production and employment.

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## Notes

1. Austrian school of economy is a special systemic look at the economics based on the methodological individualism, subjectivism, the unique epistemological function of the entrepreneur and the market process, not on the equilibrium. Among the main representatives of this school are K. Menger, O. Bem-Baverk, L. von Mises, F. von Hayek, M. Rotbard, etc.
2. The individualism as a principle of philosophical, praxeological and historical analysis of human activity means, that all actions can be referred only to certain people and no scientific method can successfully explain how certain external events which can be described by natural sciences methods create in human brains certain ideas, axiological statements and intentions. The individual in this sense is something that cannot be separated into the elements, it is the beginning and the end of an every attempt of human action analysis.
3. Catallactics is a science about nature, cause and consequences of an exchange within the framework of the market system, including material and non-material resources. All non-material factors are also objects of catallactics.
4. The Great depression from a point of view of Austrian School is in the work of M. Rotbard "The Great depression in America" <http://www.irisen.ru/books/izdannye/myurey-rotbard-velikaya-depressiya-v-amerike.html>