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Will human Action by Ludwig von Mises Help Understand What Causes the 2008 Economic Crisis?

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Abstract

Ludwig von Mises was the acknowledged leader of the Austrian School of economic thought, a prodigious originator in economic theory, and a prolific author. Mises's writings and lectures encompassed economic theory, history, epistemology, government, and political philosophy. His contributions to economic theory include important clarifications on the quantity theory of money, the theory of the trade cycle, the integration of monetary theory with economic theory in general, and a demonstration that socialism must fail because it cannot solve the problem of economic calculation. Mises was the first scholar to recognize that economics is part of a larger science in human action, a science that Mises called «praxeology». Austrian business cycle theory has a legitimate claim to being the most authoritative explanation of the recent global financial and economic crisis. Indeed, many mainstream economists have begun to analyze the crisis, perhaps unwittingly so, in terms that sound as if they were derived directly from the Mises theory of macroeconomic fluctuations. Even advanced economic research into financial leverage and liquidity does conceptually little more than develop the framework of Austrian business cycle theory.

Jel Classifications: G01, H3, N1.
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1. Introduction

The past two decades have witnessed the challenging economic & financial landscape globally. While the financial crisis in 1997 was triggered by the devaluation or slumping of several major currencies in Asia and mostly contained in the region, the 2008 economic crisis has a widespread effects in the developed economy from the United States where it was triggered on sub-prime mortgages and spread to European sovereign-debt crisis.

The 2008 economic crisis has a very interesting perspective on how the diversity of financial product offerings and creativity with modern financial instrument yet failed to help the nations for greater wealth. And it's disheartening to see the effect of the turmoil not only on the usual suspect of rising unemployment but the crisis have sent many towards a homeless state with longer and harder prospective of recovery.

Despite several major economic setback such as The Era of Depression and other significant event of crisis every now and then, yet almost the same error been repeated. The way the economy evolves over time is also shaped by the way business, social and to the certain extends political motivation, interact or influence. The business requires extensive credit where possible for expansion particularly during the boom period and subsequently the society demands more access to credit facilities being for the mortgages, education or better lifestyle. It may happen that the government allow for more room on credit expansion and a more relaxed financial policy and regulation to maintain its position and to ensure the continuing support from business and the people.

One interesting aspect of the integration between the business, human and the government is the position of human to shape the way resources been mobilized in the economy. While the economy always moves in a cycle, unfortunately human tends to forget on the overheating of economy when the stock market reached its peak, soaring real estate prices and strengthening currencies. Human pretends that the bulls run will remain positive or last and no turning back. This is where the problem starts and triggers to the depth of economic crisis. Mises in his book "Human Action" clearly stated that many champions of the instinct school are convinced they have proved that action is not determined by reason, but stems from the profound depth of innate forces, impulses and instincts. The emotions disarrange valuations.

2. Brief analysis on the 2008 Economic Crisis

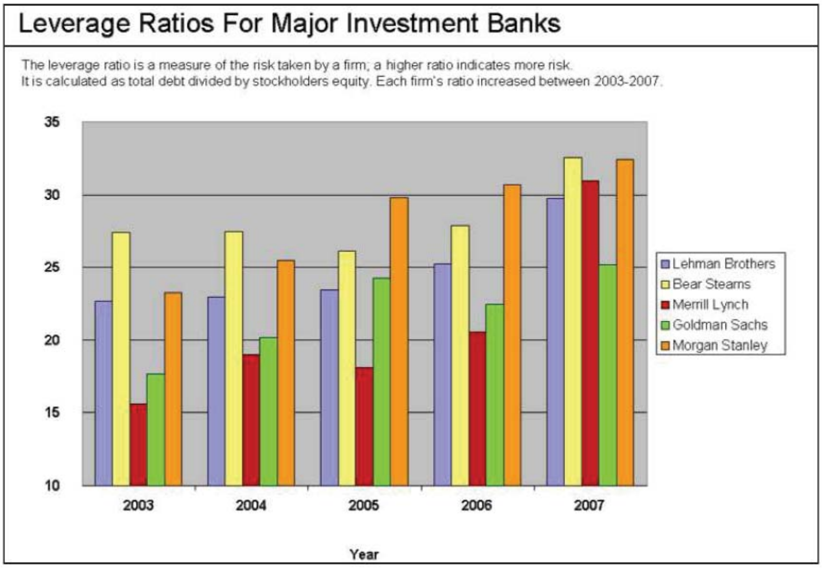
While the world has seen the instability of the economy resulting from fluctuation in major commodities and fuel, the over expansion and accessibility to credit without proper check was considered the contributing factor for the crisis. The reason is a simple as it effects the financial sectors which tend to borrow fund from one to another and the people who were given the access to more credit on the real estates without good or approved credit rating.

How significant it has been that it spread into Eurozone crisis and slowly gripping the other bigger economy likes China. The concept of the crisis was due to dramatic change in the ability to create new lines of credit including high risk lending, which then dried up the flow of money and slowed new economic growth. These hurt as the financial institutions, business and people were left with the depreciating value of assets and the inability for repayments. To worsen the situation, the cheap credit without proper assessment has created the demand position without value and thus creating a bigger inflation[1]. The art of leveraging in the financial institutions went uncheck for longer time due to the growth that has been overlooked and waiting for the time to bust. The period of credit expansion always sooner or later been followed by a period of depression.

While the concept of granting a wider access of credits to the general public whom were previously denied due to the high scrutinizing of the financial record and to have a home was a noble moves supported by the government, it was unfortunately moved into the greedy aspect of business in the sub-prime lending that led into excessive borrowings. Mortgage lenders kept granting the credits without feasibility for the borrowers on mortgage repayments. Higher interest rates were charged to the loans but the people were more than happy to get the loans hoping that the real estate boom will keep upwards trend. The financial mechanism used by the financial institutions was rather dubious. The lenders passed the risk of default payments to the mortgage insurers or package the mortgages as mortgage-backed securities[2]. It sound easy but these highly complex financial products and instruments overlooking by the credit rating agencies and the respective central banks and financial regulatory have resulted in massive stumbling block in the credit expansion and foreclosure, tumbling stock prices, weak investors and public confidence and the respective government at stake.

FIGURE 1

Indication of highly leverage financial institutions in The USA



Source: Company Annual Reports (SEC form 10K).

The above data reflects the financial institutions exposure to the credit riskiness. In five consecutive years prior to the crisis, the five major investment banks had expanded their risk exposure beyond their capability and subsequently becoming less resilience to absorb further losses. From 2004-2007, the top five United States investment banks each significantly increased their financial leverage which increased their vulnerability to a financial shock. These five institutions reported over USD4.1 trillion in debt by fiscal year 2007. At the height of the crisis, Lehman Brothers was liquidated, Bear Sterns and Merrill Lynch sold at much discounted prices while Goldman Sachs and Morgan Stanley became commercial banks[3].

Highly complex financial instruments such as off-balance sheet securitization and derivatives used as the instruments to expand their credit portfolios were difficult to be regulated and much overlooked by the financial regulators. These so called innovative financial products did not have the necessary financial backed up by the banks at the time of crisis neither did they anticipate the massive losses encountered.

The observation by Mises on the crisis which continuously occurred to date was mainly due to the human mistake and overlook from the way economy should be managed. It is obvious that the economy is designed for the betterment of the people as desired by the government, business and the public. Unfortunately, due to the different interest and desires of these groups for prosperity, they have led the economy to the different outlook, approach and perspective which at times unmanageable and unthinkable.

In the preface of Mises (1934)[4] "The Theory of Money & Credit, he mentioned that the difficulties of the monetary and credit system are only a part of the great economic difficulties under which the world is at present suffering. It is not on the monetary and credit system that is out of gear but the whole economy system. In a true reflective of his words, we have seen diverse economy setback to date while the 2008 crisis has seen the wider adverse effect globally.

In order to further elaborate that human action was the cause of the economic crisis as mentioned by Mises, the discussion will be segregated into three areas i.e. the government influence, business goals and human desire.

2.1 The Government

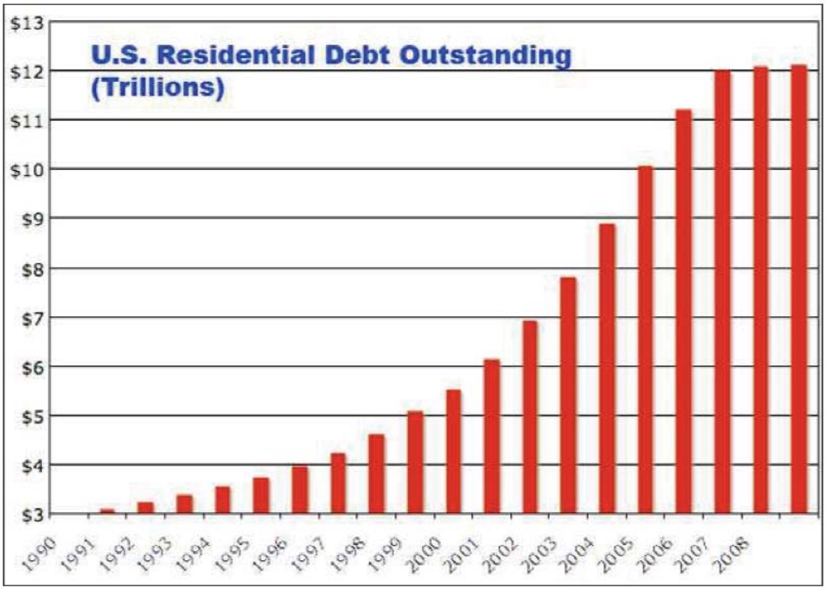
The wealth of the nation is significantly influenced by the policy and mechanism established by the government. In order to ensure continuing support from the public, a sustainable economy growth with sound policy is hence necessary. The government may require more financial resources to implement the policies and plans. The government may establish various fiscal and monetary measures to step up the economy the way the public desires and in return to receive support for maintaining their positions.

As the economy crisis in 2008 was triggered by the extensive and unchecked subprime lending in The United States, it would be significant also to analyze the role of the United States government that triggered the crisis. The government intention initially was to provide better homes for the people through a pilot program of which The Fennie Mae as the country biggest underwriter of home mortgages was requested to find a way to get more loans for "borrower whose incomes, credit ratings and savings are not good enough to qualify for conventional loans"[5]. While the initiative was noble but the implementation without further consideration and checks have resulted into plunge when people just simply could not afford to pay back the mortgages. Did the government initiate the plan without prior analysis on the pros and cons of such plan?

I believe that such measures taken by the US government unfortunately has led to further speculation in the property market. The financial sectors taken the cue from the government had taken the advantage of the 'relaxed' rules on the requirement of the mortgage facilities. As demand for the housing increased, so did the mortgage accessibility by the financial sector grew as well.

FIGURE 2

US Residential Debt for the past two decades



The above data from the US Office of Federal Housing Enterprise Oversight indicated the increased of the mortgages which quadruple as the credit were widely available and subsequent increase in the property prices particularly over the last 10 years i.e. 1999 when the idea was mooted out by the Clinton government till prior of the crisis in 2008. Prior to the asset bubble, the housing segment alone contributed to USD12 trillion of the credit expansion with a GDP of USD11 trillion annually[6]. In about ten years, the credit extension was so massive than other sectors financially. It was a boom period and that was what the government or any other government would want to. The government was pleased with the amount of taxes as this sector alone attracted further spending in infrastructure for building houses and creating more employment. The people were happy as they have the ability to spend more on the credits and started to invest heavily on the property sector. This is when the problem started to arise. It's a simple human psychology aspect in economy that has always got them in a crisis. In a good time, people tend to forgive and forget.

In many democratic elected governments, the economy is normally a public private relationship and establishment. The government as much possible would want to have the enterprises to strive in order to create job opportunities and increased spending. Hence, the government would provide as much stimulus packages and allow the expansion of financial investments and instruments to ensure growth and diversification in generating income. As such, the financial sectors through a strong growth in the financial institutions are considered significant and necessary by the government.

However, managing the financial institution and the complexity of the financial system itself is not an easy task for the any government especially like the United States because of its mixed economy. The government should have taken a rather cautionary measure while introducing any plan to expand the economy. The government may look into the positive perspective aspect when introducing the scheme through several financial government agencies such as Freddie Mac, Fannie Mae and Ginnie Mae. The loans, in effect, guaranteed by the government i.e. if the homeowners defaulted, the government will then pay off their debts[7]. In order to do so and to avoid further risk to the mortgage provider, the mortgage bond market was established which was well received by the Wall Street and investors. Here is how the problem started. The government has helped to engineer the crisis for a long while as the mortgage bond market was well received by the respected players such as the big players such as Solomon Brothers, Merrill Lynch and Citibank.

The reason the meltdown occurred was partly because the United States government failed to monitor and control the financial institutions during the boom period. The government allowed the complexity of the financial instruments such as the mortgage bond market to spread and leveraged beyond the capacity of the banks themselves. It was alarming that the government failed to realize the overheating of the real assets based on the financial report and statistics on monthly basis on the segment. It probably due to the government allowing the market to expand and the Wall Street to hit the highest possible while believes that the market can do its own correction. But what the government failed to realize was that the destruction and the meltdown itself was so massive because the United States is no longer in situation as it was before such as during the Great Depression as the market is later much more complex than before. But the very least was the government should have realized that the situation that they were facing before the 2008 economic crisis has a striking similarities as in 1929. The post-World War 1 had seen the United States economy expanded to a record high that finally saw the bubble simply grown too big for its own good that when it hit 1929, the Great Depression saw the US economy collapsed big time.

The government and the financial institutions have always been a mutual partnership for ensuring growth. Most of the planned activities by the government are done through credit expansions facilitated by the financial institutions. The lending helps to expedite the economic expansion activities particularly on the infrastructure and other heavy weights activities that generate more employment opportunities and spending. According to Mises[8], political and institutional convenience sometimes make it expedient for a government to take advantage of the facilities of banking as substitute for issuing government fiat money. As the treasury office borrows money from the bank, the treasury will then be a debtor to the banks. The concern is how much borrowing by the government is sufficient enough or not going beyond its mean to support the economy.

While the government may have all the statistics on employments, gross domestic products and inflationary in check, it may have been the case that human factors desiring for more may lead to the continuing expansion in credits to ensure continuing growth. Economy arguably may not necessarily be reflected by the data to justify certain measures or to predict the future. The government may use the economic data as a way for further investment and to improve its credit ratings, or as a reflection of how the government may be able to predict support prior to the elections.

Mises argue that if one wants to avoid the recurrence of economic crises, one must avoid the expansion of the credit that creates the boom and inevitably leads to the slump[9]. While the credit is a way for expanding businesses, however, the nature of the credit should be analyzed and checked to ensure non exploitation and greediness.

The concept of credit is the availability of fund via loans depending on the needs and the nature of business. The credit expansion, however, is the policy where the central bank produces additional money in order to purchase debt from the government or from entrepreneurs such as banks[10]. Hence, the basic policy of the credit expansion is broadly accepted as a measure to make people prosperous. This basic policy widely used by the government as the way to facilitate the growth in public and private spending is what the argument by Mises on the human action that led to economic crisis over the century. The credit availability as desired by the government was indeed not really the fund generated by the government but instead through the central bank that produces additional money to purchase the debt from the government and the most viable alternative is through the lending available by the businesses such as the banking sector. In order to further assist the private sectors such as the banking sector to provide wider credit access to the business and the people, the government in return provides them with the much favorable rate of interest to ensure their business sustainability. However, in most cases, the availability of more credit may not necessarily indicate certainty of further growth and expansion. The boom period resulting from the over expansion of credit may be temporary. The expansion of credit that goes unchecked may result in excessive borrowing over speculative and non-productive activities.

In many cases, the government believes that in order to initiate growing economy, it should jump start the economy through the public spending. In many ways, the spending here is mostly focused on the main infrastructure sectors, energy and natural resources sectors and through creating jobs in the government sectors. These will hopefully create more demand in other sectors of business and economy. Though the credits require for the public spending are available, however, some of the public spending can be much higher in terms on the cost of borrowing to fund the projects, the long term viability and sound management. These may result in uncertainties and may raise concern over the sustainability. The government may have the confidence in repaying the loans but it may not be perceived the same from the investors and economists in general. The government may not likely to sustain the same policy over the time and may subject to changes depending on the economy and political climates.

The government may also adopt the policy which may contradict the anticipated growth in economy. In the United States, the overall middle class families saw their income fall during an economic expansion period from 2001 to 2007 due to Bush tax cut policy[11]. In many developed and developing economy, the role of middle income earners in economy has never been understated. They have played a significant role in influencing the economy and its purchasing power to keep the economy momentum going. However, despite the fall in income, the US government at the same time providing the facilities through the banking sectors to provide more credits line on mortgages. It has created even further unevenness in the economy as the government was allowing the people to spend further beyond their means.

Prior to the 2008 economic crisis, the government could have read the sign or anticipated the slowdown in the economy. However, the government might not anticipate the reaction from the investors and the business alike to be worst than it could have thoughts. The policy of credit expansion has always been the government way for growth. The same policy of credit expansion has an interesting phase of boom and bust. The policy was prevalent in the United States under President Woodrow Wilson after the establishment of the Federal Reserve under the Federal Reserve Act in December 1913[12]. Since then, it has caused major credit booms and crunches in the form of assets booms and subsequent crunches and economic booms and subsequent recession. The cycles had been obvious in the years of 1929, 1987, 2001 and the recent 2008.

It is unfortunate that despite the setback from the excessive credit expansion from the past, the government is still applying the same approach and mechanism for growth. Many have thoughts that there is a cycle of boom and bust over a period of time in the economy cycle. However, what may have been overlooked is the size and magnitude of the slump such as in the 2008 crisis. The way the government interacts with the business in the ever changing economy landscape and business diversity at times makes the government decision to be dated. Business landscape changes in many directions as it is highly exposed to the global market. Trades on commodities, currencies and stocks go across the global in 24/7 that they have almost integrated and may influence the country's economy.

The government may have taken rather the popular decision instead of the real needs for the economy to stay in power. It may sound controversial but in may happen that such decisions have to be made. Many sound government wish for easy money policy. This policy will enable the government to quickly find the necessary funds to support the its work plans and to reflect to the businesses locally and abroad on the sound government policies established by the current administrations as well to reflects confidence for the global business as means of attracting investments. In order for the government to continue attracting businesses, it has to ensure the economic activities remain active. One of the alternatives provided by the government in attracting businesses is through lowering the tax and interest rate.

Business works in tandem with the government policy and directions. Lowering in tax and interest rate supplemented by subsidies and incentives definitely will provide the upper hand for the government in getting support and votes. However, many politicians have seen these measures as rather a winning over supports and do not look into the both the pros and cons over a longer period of time. The government always allows for the period of lowering in tax and interest rate as longer possible while the business try to extend their activities in anticipating the continuing of expansion. These have encouraged the business to grow and create more demand from the people as production increases and employment fill in. To this extends, the government may have seen the increased in the demands for credit as well the overall market. Due to the rapid growth in public spending and the private entities, it attracts further financial demands. The financial sector is the most active sectors when the economy is at the booming stage. This highly sensitive sector and considered highly leverage witness a higher demand due to the growth demand in loans. The financial institutions may then start borrowing among themselves locally and abroad institutions in meeting the demands.

This is when the government may find itself in a difficult situation of controlling the credit expansion as a sudden revision upward on the tax and interest rate may hurt the business. As Mises again mentioned[13], the wavelike movement affecting the economic system, the recurrence of periods of boom which are followed by the periods of depressions, is the unavoidable outcome of the attempts, repeated again and again, to lower the gross market rate of interest by means of credit expansion. The government at this stage may soon find itself in a difficult situation to slow down the growth activities and any sudden attempt to revise the policies and rates may cause anxiety to the market and panic that can hurt the economy.

As mentioned earlier, the striking similar pattern of the economic crisis since the first Great Depression resulting from the credit expansion to the one in 2008 made us wonder if the government may never want to learn from the past history of the crisis or simply find its way to forgive and forget and hopes the same approach may bear a different result. Unfortunately, the government failed again to get the right approach to ensure the expansion worked. The failed attempt in the credit expansion may not necessarily due to the unavailable economic and financial data that interpreted the overall situation and checked the healthiness of the economy. As Frederick Hayek highlighted in the Austrian business cycle theory that a sustained period of low interest rates and excessive credit creation results in a volatile and unstable imbalance between saving and investment. It creates and stimulates further borrowing to the business and consumers that unsustainable and widespread malinvestments. Malinvestments refers to the investments of firms being badly allocated due to what they assert to be an artificially low cost of credit and unsustainable increase in money supply. Hence, the role of government in the crisis should not be understated. It is a matter of how much is enough to ensure the supply of the credit would not over run the real need and the efficiency of the market.

The government role in economy is more significant in the boom period than ever before the crisis. The government may act as an institution but at the same time it is managed by human. As such, there is still a weakness of overlook, misuse of fund and disagreement over policies to run the government, to interact with business and to satisfy the people.

2.2 The Business

While much has been discussed on the role of government in the 2008 economic crisis, however, the business also contributed to the crisis. One of the critical aspects contributing to the crisis was how the business behaved while supporting the government policy in subprime mortgage. As much possible, any business would like to have its activities expanded and to maximize returns from the investments. Unfortunately, the businesses have taken more drastic steps from what they could offer.

In particular, the financial institutions were the main contributors to the economic crisis in 2008. Though there have been many reasons that include the volatility of the commodities prices and slower demands for export contributing to the crisis, however, in the United States, it would be much noted of the highly indebted US economy on the real estate shock. According to Fratianni and Marchionne (2009), large default rates on subprime mortgages cannot account for the severity of the crisis. Rather, low quality mortgages acted as an accelerant to the fire that spread through the entire financial system. The financial institutions had taken the advantages of the government in easing the lending policy to the non-qualified home buyer applications i.e. individuals with low income or moderate income and limited or poor credit histories and try to maximize the profits from these customers whom were previously denied of the mortgage facilities. The main argument as what Mises had been mentioning over and over again was how human action of taking excessive risk for the higher returns and non-compliance were far more destructible than was bargained for. The large default rates on subprime mortgages had become fragile as claimed by Savona (1999) as a result of several factors that are unique to the crisis: the transfer of assets from the balance sheets of banks to the markets, the creation of complex and opaque assets, the failure of ratings agencies to properly assess the risk of such assets, and the application of fair value accounting. It would be interesting to note on how the risk exposure of these loans was the least in the firms evaluations in justifying the lending.

It would be worth to mention here in the business context on how the crisis was initiated, fueled and finally led into the biggest economy catastrophe in the history reaching beyond the era of Great Depression. The US government sponsored agencies; Fannie Mae and Freddie Mac were entrusted to provide loan facilities to the much needed lower and middle income earners for affordable housing. It was estimated by 2007, the US government expected Fannie Mae and Freddie Mac to show that 55 percent of their mortgages purchases directly received by the low to moderate income loans, 38 percent from the underserved areas (usually in the inner cities) and further 25 percent were to be loans to low income and very low income borrowers. Such a large percentage dedicated to these borrower categories though highly respectable for the initiative has led to the unprecedented default and overlook by the rating agencies and the government agencies on the ethical and unregulated aspects of the borrowings.

Due to the US government requirement which mentioned earlier for affordable and accessible housings to the mass, in 10 years i.e. over the period 1994-2005, the growth in the home ownership had reached to an unprecedented record high. In 1994, subprime loans were five percent of total mortgage origination; and by 2005 it had risen to 20 percent. And the interesting part was the annual growth rate of this sector alone at 26 percent and expanded the program to an estimated 12 million home ownership (Fratianni, Marchionne; 2009).

FIGURE 3

Annual growth of US households' debt and mortgages

Source: Board of Governores of the Federal Reserve System, Flow of Funds Accounts of the United States.

Based on the explanation earlier and reflected in Figure 3, the expansion of the lending reached its peak in 2002 to 2005 indicating the increase gap between the household to the mortgage subscribed. The steady increased in the mortgage demand over the decade had created a boom in the housing industry particularly for the cheaper housing alternative through credit expansion. The pressure by the government, the ease of borrowing policies adopted by the government sponsored agencies and the pressure to achieve the targets have led to another two biggest components of the crisis i.e. the ethical aspects of the lending and the way the loans were structured to ensure the expansion and continuous growth in the subprime lending.

It is widely acknowledged that at times people are taking advantage over the loopholes or weaknesses in the system to achieve their desired goals. A decade prior to the crisis, the loan growth achieved an unprecedented 12 million home ownerships. The risky part of the business was of course lending to the almost none or less qualified home borrowers and definitely led to the significant deterioration of credit standards at both end i.e. the borrowers and the financial institutions. It was reported that at the height of the borrowings, a great deal of the loans was made by independent, federally unregulated through various sub agencies to have the loans more accessible. The argument for such acts unregulated becoming less apparent as it created a steady increase in booming property markets which was much needed to expand the economy. The declining lending standards were then correlated with rapid home price appreciation. It was unfortunate that such obvious negative correlation between the total household and the rapid rise in mortgage (as in Figure 3) particularly while the mortgage was dominated by the lower category of income with higher risks of inability to repay should the further bust or slump in the property market was totally ignored. Adding to the already deteriorating lending standards was an expensive monetary policy that further aggravated the whole situation. The concern from the Austrian economy that continuing credit expansion to create growth in economy and further expansive monetary policy would bring more destructive act at the end than the short term prosperity or benefits would be the most obvious outcome in this aspects.

It's interesting to note that granting the loans to the lower income brackets may not be possible and easier as it might appear to be. It was claimed that due to lack of federal regulations aspects on the lending, the lenders then provided the loans with applied adjustable rates that resulting in higher cost of borrowing over defaulted payments which also called the teaser rate. Other practices such as excluding taxes and interest rates from escrow accounts and prepayment penalties were commonly occurred. These happened as of the mutual interest and understanding between the people who took the opportunity to have a home and also for refinancing as well as the financial institutions which took the advantage of the situation knowing that the possibility of defaulting was higher.

While the human desire for a more profitable ventures when the opportunity arise as in the instance prior to the crisis, it would be interesting to review at how the mechanism and the complexity of the financing schemes adapted by the financial institutions aggravated and deepen the situation. One of the important aspects of the lending is called structured finance. In general term, structured finance can be described as a sector of finance that was created to help provide increased liquidity or funding sources to markets such as housing and to transfer the risks. In direct definition, the mortgage market applied structured finance to provide liquidity to lenders and funding to the borrowers. The common instruments used are the collateralized debt obligations (CDO) and asset-backed securities (ABS).

The concept of structured finance here was the loans provided to the customers which were packaged and sold from the appointed brokers or from the originating bank and later provided the loans to the financial market. The loans were then repackaged and sold again into sponsored structured investment vehicle (SIV). The issue here was due to the fact that such financing is highly transferable; it created demands for the products that many of the commercial and investment banks rushed to get the hold of it. All the major banks in the United States as highlighted in Figure 1 had become highly leverage and exposed their shares to the highest level of vulnerability on instance of the property slump or crash. When the crisis was at the peak, the banks reacted by selling assets to reduce leverage, and thus setting in motion a vicious circle of asset liquidation and price declines across a vast range of assets.

The other important aspect of the almost instant meltdown to the crisis may also be contributed by the oversight of the rating agencies to properly assess the risks of the assets, the type of investment made and the application of the fair value accounting. I assume throughout the decade of the boom period, the rating agencies could have been busy evaluating the potential return of the assets instead of reviewing and investigating the risks such as securitization where the exposure on risks are higher and least transparent. It has resulted in way that the bank to keep expanding their lending portfolios. Hence, at the subprime mortgage crisis, the banks were hit the hardest as they were undercapitalized in which they failed to ensure that they have sufficient capital or insurance to cover the risk of mortgage defaults in the event of housing price bubble.

The complexity of the financial instruments applied throughout the period was not in any way improves the better part of the economy of the home owners. The highly leverage financial position of the banks made them more vulnerable to the shock and they will then transfer the losses to the customers i.e. the home owners. The investors then realized that the banks had being overly leveraged and later demanded for a higher rate of returns failing which saw the significant drop in the United States stock market particularly financial related stocks. It was an unfortunate situation that the government failed to really understand from the very beginning the scope and control over the decade of highly leverage financial institutions, the extent of loans provided to the buyers and the inability of the rating agencies to properly evaluate the complexity of the financial instruments.

Mises in his book Human Action had clearly stated that it would be a serious blender to neglect the fact that inflation also generates forces which tend toward capital consumption. One of its consequences is that it falsifies economic calculation and accounting. It produces the phenomenon of illusory or apparent profits. These were what really happening prior to the crisis. Due to the abundant availability of money fueled by the availability in the line of credits, it has resulted in over consumption beyond necessary to the point of exploitation of the resources available. As businesses grew due to the increased demand of their products, they were then willing to put on a premium to get the production going and pay a higher rate to the bank. The same concept applied to the property lenders. They were willing to pay higher rate as it was the opportunity to have an assets. When the crack started to appear, the businesses find themselves stuck with lower product demands, and hence slowing down the production line which resulted in reduced employment. The employees who were laid off subsequently were not able to meet their loans obligations and defaulted. The banks then having the repossessed properties in hand with much lower depreciated values were not be able to meet their own liquidity requirements. To further illustrate, we can also look into the three-month interbank lending rate in the US against the three-month US. Treasury bill which contained between 20 to 30 basis points. By the time the crisis hit the infamous Long Term Capital Management, it peaked at 120 basis points and by October 10, 2008, it reached an all-time high of 464 points ended in a historic week of panic selling in the equity market. The surreal anticipation of short term profits was obviously deteriorated further as witnessed in the 2008 economic crisis.

2.3 Human Behaviour

The third element of the 2008 economic crisis was also contributed by the people at large. Many households in the US were leaving beyond their means and for a long time, they have continuously living on credits such as for housing, educations and credit cards. Hence, many of the Americans may not have the good credit score or ratings due to the continuingly increase in the cost of livings. In addition, the increased cost was not supported by the parallel increase in savings and income which remained flat for the past ten years prior to the crisis. Definitely, a further incentive by Clinton administration then continues and expanded further by Bush administration for greater accessibility to mortgage facilities overlooking their credit rating was widely welcomed by the people whom already have financial issues.

What happened next was the more interesting aspect of human behavior in taking the opportunities from the government policy. Providing loans to the masses without even a down payment and failed credit ratings were the utmost disaster financially over a longer period. The ease of lending requirements have resulted in affordable homes to the public and hence created higher demand in the real estate sector. From the late 1990s into mid-2000s, housing prices in the US rose at a compound annual growth rate of 8%. The consumers were feasted on the equity in their homes, taking a total of USD12 trillion via loans, refinancing and sales. The staggering amount of the loans where the bulks of it was provided to the people with lower credit rating and higher risks in particular might not resulting in the desired outcome for sustainable growth but rather the opposite. People were taking advantage for more loans as conservatively thought that real estate investment was much secured. Unfortunately, people did not realize or fail to understand the repercussion from the over borrowing neither did the financial institutions and the government. The ratio that measured household debt to GDP doubled from 50% in the 1980s to 100% GDP by the mid-2000s. The last time the level of debt was 100% of GDP was in 1929, the beginning of the Great Depression[14]. The striking similarity had been overlooked simply because it's the human psychology and social being that they desired for more than what they could bargain. They were blind-sided by the continuing growth due to the boom in the real estate market they created demand outstripping supply. Not many may argue on how the financial institutions could keep providing more loans to the masses. Indeed, the financial institutions taking the cue from the unprecedented demands by the public for loans and the availability of structured finance schemes had allowed them to subscribe for more risky mortgages. This so called lucrative gains have resulted the bank in borrowing more than they could afford neither that could match their assets. Hence, both the people and the financial institutions were caught by the same situation of over borrowing than what they could afford for.

The human behavior aspect that contributed to the crisis is now become more apparent than ever before as mentioned by Mises on the concept of Praxeology. A decade prior to the meltdown, the Asia region was significantly hit by the financial crisis signaling to the global economy on the need for a further check and balance on the growth and credit expansions. Yet, the US government failed to understand and learn from the crisis as it would probably due to geographic reasons and the Asia turmoil was overlooked by the change in political climate in the region. The public in the US just kept spending and the financial institutions were allowed to underwrite and trade instruments such as mortgage-backed securities. The hunger for higher returns has overlooked the risk factors and went unchecked for a long time. David Beim, a finance professor at Columbia Business School believed that the reason for the crisis can be described as follows:

"The problem is not just the banks, greedy though they may be, overpaid though they may be. The problem is us. We have been living very high on the hog. Our standard of living has been rising dramatically over the last 25 years, and we have been borrowing to make much of the prosperity happen. We have over-borrowed, and we have done that over many, many decades. And now it's reached just an unbearable peak where people on average cannot repay the debts they've got".

It is difficult to fault on the real estate investment neither does the requirements for growth on the crisis. Yet, it was the greed and hunger for more than drive people to ask for more that went uncheck for a long time. The government allowed the financial institutions to create more access and convenience for lending without a good credit standing. People have been accumulating debts as much from the credit cards and education loans and the government was fueling more debts to the people by allowing the mortgage lending that will inherent to their financial commitment over a longer period of time.

Many modern economists argue that human elements can influence the way market moves and provide a better understanding on the economy. It is due to the available of various statistics and data gathering methods that can interpret the financial data more concisely and the economists interpreted the data accordingly. However, the data available are merely the figures that have limitation on understanding the way and the desire of the human to act according to their interest. People always forgot that there is a limitation in the resources that if managed unwisely may result in undesirable outcome. Prior to the crisis, particularly in 2005, the housing prices reached a record high before the housing bubble started to ripple in 2006 creating massive panic as people defaulted on their mortgages and derived the infamous foreclosure episodes. The financial institutions which were busy subscribing to the loans found themselves caught with lists of unattractive and much depreciated properties that kept pushing the housing prices further down.

The default payments did not comprehend well the investors at the Wall Street. The riskier mortgages concept subscribed by the banks were no longer a favorite among the investors and almost overnight sent the panics that went straight to financial institutions share prices. All the biggest commercial and investment banks were caught with the sudden crisis that resulted in further panic in the stock market. Stocks on the financial institutions were dumped as they had started to realize on the wrong approach taken by the banks on the mortgages.

The stock prices tumbled as the banks started to default on their loans. What could be worst was the defaults in the mortgage crisis were the default payments from both the people and the banks. It's almost a double jeopardy as the credit markets started to freeze up, and individuals and business alike could not get the loans and almost stalled the economy and in the US and the spiral affect went further by late 2008 that gripped further to the world economy. Unfortunately, the mistake went unchecked for such a long time that by the time the crisis hit, it was then too late to fix as the amount involved was far too great to comprehend and the panic from the street to the Wall Street did not help the situation either.

Andrew Lo, a professor of finance at MIT Sloan School of Management once quoted in November 2008 testimony before the House Oversight Committee Hearing in Hedge Funds stated that *"the financial crisis may be an unavoidable aspect of modern capitalism, a consequence of the interactions between human behavior and the unfettered ability to innovate, compete and evolve. Free enterprise is always the right answer. The problem with it is that ignores the human element. It does not take into account the complexities of human behavior"*.

The modern technology has allowed for the business particularly the financial transactions be made beyond borders and has allowed for range of financial products and techniques. However, the complexity of the modern financial instruments may not necessarily result in the desired outcomes or better returns. The 2008 economic crisis has witnessed the financial instruments that used and applied for the mortgage lending to the certain extend be exploited by the unscrupulous act of greedy and ignorance for a quick return. The unregulated to the certain extent of these financial instruments by the relevant authorities and the lack of qualified review from the rating agencies particularly prior to the crisis have escalated further the crisis. It seems like the whole growth in the real estate sectors a decade prior to the crisis almost looks very financially cosmetic. Allowing for the lenders to get more loans on negative or low credit ratings would always not a very good and strategic idea over a long period of time as the household income slower growth did not correspond to the housing prices. The financial institutions on the other hand provided the loan though acknowledging the risks then charge a higher interest rate to the buyers on default. In addition, the banks did not care much on the risks as they could end up owing the property on default payments by the buyers and selling the loans to hunger investors in the Wall Street which at the initial periods was considered minimal risks that subscribed by almost all banks major and small players.

It is very interesting to note on how far the banks can continue the business on lending to consumers while at the same time applied the same concept of lending to other banks to support the credit expansion in the mortgage markets. It is also quite difficult to comprehend the overlook of the Wall Street from what would happen next. The stretch of the mortgage lending came to the point of housing bubble that could have been under estimated by the governments, the Wall Street, the financial institutions and to the people. The ultimate outcome from this is the massive foreclosure that resulted millions of people out of employment and left with nothing as their homes were then taken away by the banks.

What had been mentioned earlier by David Beim and Andrew Lo earlier clearly indicate the weaknesses of the human in managing the resources and the desire that at times overlook the needs and necessity. While the business may have the opportunity to recover with the help of the government through bailout and incentives, unfortunately it was the same for the people. Their homes were taken away and sold at much depreciated price and yet they were left with nothing but to pay the remaining loans that came with higher defaulted interest rate.

3. Conclusion

The above discussion, I believe is not far from the concern highlighted by Ludwig von Mises on the human action that partly caused to the economic crisis not only in 2008 but prior events in the early 1900s and the subsequent events that followed. The interference of the government into the market by influencing the banking sectors to ensure growth and sustainability have led to at times the credit expansion and the boom to bust cycle with painful adjustment along the path of recovery. Mises claimed in his business cycle theory that the credit expansion by the banks, in addition to causing inflation, makes depressions inevitable by causing malinvesment i.e. by inducing the businessmen to overinvest the capital goods and underinvest in consumer goods[15]. The era of boom period was normally associated with higher spending and less savings that might cause the undesirable inflation affect to the economy. The spending at times may also be so excessive that big projects were created only to fulfill the employment with minimal return, inefficiency spending and waste. These happened as due to the credits availability and the credits alone may subject to abuse in spending as it can be politically motivated and influence by certain business or enterprise decisions.

In my opinion, the subject on whether human actions as mentioned by Ludwig von Mises in the context of 2008 economic crisis is very much relevant. There have been many arguments on who was responsible on the crisis as much as to the cause of it. According to Steverman and Bogoslaw (2008), the crisis was very much caused by almost everybody that involves in the crisis i.e. the commercial and investment banks, mortgage lenders, credit-rating agencies, insurance companies, regulators, politicians, government-sponsored entities, investors and the homeowners as well. These are the people who mooted the ideas, implementing the actions and subscribing it. They were the ones who denied the level of tolerance for the risks and made the whole system counter- productive and less efficient. People were misled on the concept of real estate investment that there's a thin fine line of what they could afford and paid for.

Mises argued that credit expansion created excessive money supply and dislocation to the market that could end up in inflation. The easy money policy adopted by the government through credit expansion in a way help to create the temporary boom or business cycle that may have the downturn. Mises mentioned that attempts to carry out economic reforms from the monetary side can never amount to anything but an artificial stimulation of economic activity by an expansion of the circulation, and this, as must constantly be emphasized, must necessarily lead to crisis and depression. In economic sense, there is a need for a period of adjustment at any level when it reaches its high and is a matter of how much could the adjustment needs to be. The government may not always correct in adopting certain policies and influencing the business to follow the policy without continuous check may cause more harm than good. In many ways, I believe Mises was also concerned that human behavior at times can be unpredictable and may have caused error in judgement.

In the era of modern business approach, techniques and technology that can derive the business for more diversification and developing new financial instruments, nothing can be more importance than having a good corporate governance to counter check the soundness and the viability of the business. Previous studies have indicated that at the times of growth, the bankers tend to over rewarding to the top management and investors alike to prove to people that they were at the top of the game and to convince people that whatever happened inside the bank, they can be trusted. But unfortunately, not many can argue that for a decade of highly leverage and over borrowing by the banks, the crisis just waiting to happen. People are more than happy to discuss on the growth, profitability and expansion and least interest to discuss further on the subject of risks. Business and politics are intertwined and relying on each other for support and growth. In the US, the politicians rely on corporate Americans for their campaign contributions and in a way could have influence the business deals and may cause a conflict of interest. It may happen that the politicians may overlook or relax certain aspects of regulation for the sake of the politics and promise in the campaigns. Again, Mises argue that such influence by the government to the business may have adverse effect over the business over a period of time. Mises concluded that the only viable economy policy for the human race was a policy of unrestricted laissez-faire, of free market with the government strictly limited to the defense of person and property within its territorial areas. I would say that we should always revisit the history of prior crisis and the recent economic crisis to understand the cause and the root of the problem. We may have forgotten on our action during the boom period but the very least is that people being the government, the business and the society should be constantly be reminded on the implication of their behavior at any given time of economy and the practice of sound corporate governance as a check.

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