I. INTRODUCTION

The present paper considers the relationships – logical and historical – between F.A. Hayek’s early business cycle project and his later arguments concerning spontaneous economic orders and the methods appropriate to their investigation. It is a peculiar fact, which familiarity with the contemporary literature on Hayek and the modern Austrian school cannot but make manifest, that those who praise Hayek’s business cycle work often disparage or simply ignore his later writings on spontaneous orders and vice versa. The fact that in branching out from his early interest in the cycle Hayek came to accept the validity of methods other than the praxeology of his mentor Ludwig von Mises and “methodological individualism” (whatever this squishiest of squishy terms means exactly) is treated in some circles as something approaching treachery against the Austrian cause properly understood. On the other hand, consider that in a well-known chapter in his (1981) The Politics and Philosophy of Economics, Terence Hutchison lavishly praised Hayek’s writings on spontaneous orders and the methods appropriate to their analysis while belittling his business cycle work as that of another, lesser man (whom he called “Hayek I” as opposed to the commendable “Hayek II”). If the arguments of the present essay are sound, then both of these attitudes are largely unjustified.

The thesis of the first (non-introductory) part of the paper is that Hayek’s later arguments concerning complex economic orders imply a broad, though by no means universal, explanation of economic-cyclical phenomena; and, moreover, that Hayek’s early explanation of industrial fluctuations is substantively, if not methodologically, an implication of this more general

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1 See, e.g., Salerno (2008, xxii-xxiv), Block (2013)…
account. If it is correct that starting from distinct premises, Hayek arrived at similar conclusions, then it’s difficult to understand what might justify – other than a dogmatic insistence upon certain methodological principles for their own sake – both acceptance of Hayek’s early business cycle theory and rejection of his later arguments concerning economic orders.

The second part of the paper offers an interpretation of the historical development of Hayek’s ideas concerning emergent economic orders that connects the central elements of the later, broader explanation of the cycle with considerations that make their initial appearance either in his early business cycle project or in writings contemporaneous and intimately related with it. If this is right, then it is difficult to perceive where one might draw a hard-and-fast line between the two projects.

II. HAYEK’S THEORIES OF INDUSTRIAL FLUCTUATIONS

Hayek’s writings concerning the emergence of spontaneous orders and the method appropriate to their analysis imply a broad (though by no means universal) explanation of episodes of economic disequilibrium.2 I call this Hayek’s *epistemic theory of industrial fluctuations*.3 The later theory

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2 I use the terms *industrial fluctuations*, *business (trade) cycles*, *recessions and inflations*, and *episodes of disequilibrium* interchangeably in the present paper. Unfortunately, none of these phrases is ideal. Hayek often spoke and wrote of “industrial fluctuations,” but it’s not clear whether this phrase is meant to imply that such fluctuations are conceived as regular and cycle-like, a conception that no one seems to accept any longer. Moreover, there is a danger in speaking of a “recession” that one will be understood to mean something different from a “depression,” although any distinction between the two is mostly arbitrary (and the less said about the multiple and ever-changing meanings of “inflation” the better). Finally, speaking of disequilibrium is unfortunate in the present context as Hayek was never fully comfortable with the equilibrium metaphor; and, to the extent that he thought it an apt expression, believed that real economies were always more or less out of equilibrium. I will continue using these terms interchangeably until a more perfect locution is invented that expresses the relevant fact that, at any given time, an economy can be more or less healthy.

3 It should be emphasized that the present paper explicates nothing more than a mere sketch of an epistemic theory of industrial fluctuations. Coloring and shading this sketch will likely require many years and several more essays. It should also be mentioned that it is no part of the present argument that Hayek *intended* to construct an epistemic theory of industrial fluctuations; indeed, it is not clear that Hayek would have unhesitatingly approved of the present
is an epistemic account of the cycle in several respects. It is built on a conceptual framework that treats economic equilibrium as a condition of well-coordinated knowledge—equilibrium exists to the extent that the relevant beliefs of individual market participants are mutually consistent and accurate with respect to the external facts. Moreover, the operation of the tendency toward equilibrium requires an epistemic device, a system of signals that conveys the information market participants require to adjust their activities to the circumstances prevailing in the wider economic order, namely, a freely-adjusting price system.4

But the theory is epistemic in another sense too: it attributes episodes of disequilibrium to human ignorance. More carefully, Hayek’s epistemic theory explains industrial fluctuations in terms of humans acting (typically, setting prices) on the basis of knowledge that they don’t in fact possess. It is this postulate that Hayek’s later epistemic explanation shares with the technical-economic account he developed earlier in his career. The latter attributes the trade cycle to particular instances of action on the basis of human ignorance, namely, bankers’ ignorance of the so-called “natural” rate of interest that equilibrates the loanable funds market and, on Hayek’s early way of thinking, the economic system itself. Thus it is that the theory according to which economic fluctuations arise as a consequence of bankers’ ignorance is just a particular consequence of the theory according to which fluctuations arise as a result of human ignorance.5

4 Of course, knowledge of relevant prices doesn’t suffice for the adaptation of individual plans to changing circumstances. Market participants must also possess some scientific knowledge, knowledge of the relevant social-and legal-institutional context, and knowledge of relevant circumstances and of other participants (Hayek 1961 [2014]). Hayek offers an extended discussion of the definition and requirements of plan adaptation in the fourth lecture – “The Communication Function of the Market” – of Ibid. See also Vaughn (1999).

5 It is tempting to make a too-easy joke here about the dubious status of bankers qua human, but it might undermine my argument, so it is better left unsaid.
Hayek’s unique – epistemic – conception of equilibrium starts from the premise that the knowledge that exists at any given time with respect to the scarcity of economic resources is necessarily fragmented and dispersed across all of the individual agents in society (Hayek [1945] 1948, 77). Hayek argues that to postulate a tendency toward economic equilibrium is to assert a tendency for these bits of fragmented and dispersed knowledge to become both better coordinated with each other and in closer accord with external circumstances (Hayek [1937] 1948, 45). Not all knowledge is relevant to the tendency toward economic equilibrium: “it is only relative to the knowledge which a person is bound to acquire in the course of the attempt to carry out his original plan that an equilibrium is likely to be reached” (Ibid., 53).

This means that, for Hayek, equilibrium obtains to the extent that the set of economic plans of market participants can be understood as one internally consistent plan realizable on the basis of the circumstances (and participants’ expectations concerning changes in these circumstances) that then obtain (Ibid., 41). The state of an economy relative to a position of equilibrium is a matter of the extent to which the foresight of plan-makers is correct in this sense. However, Hayek emphasizes that a state of equilibrium is a (perhaps heuristically useful) fiction (Ibid., 44; also Hayek [1928] 1984, 76). In order for a state of equilibrium to be realized, external circumstances would have to remain constant relative to expectations long enough for plans to become perfectly adapted both to each other and to these circumstances; but the required constancy of circumstances relative to expectations never obtains (Hayek [1945] 1948, 81-83), which means that every non-imaginary economy is always more or less out of equilibrium.

Thus, Hayek makes economic equilibrium a social-epistemological concept. The solution to the economic problem – “the problem we try to solve when we try to construct a rational economic order” (Hayek [1945] 1948, 77) – is the answer to the question of the economic system
in which the tendency for the foresight of plan-makers to become more correct is most effective.

Constructing a rational economic order is a matter of realizing the economic system that allows plan-makers to – as quickly as possible and with least error – adapt their plans to the constantly changing circumstances of the economic environment (Ibid., 78-79).

Hayek argues that the solution of this problem depends on the comparative importance to the tendency toward equilibrium of different varieties of knowledge, “those more likely to be at the disposal of particular individuals and those which we should with greater confidence expect to find in the possession of an authority made up of suitably chosen experts” (Hayek [1945] 1948, 79-80). Assuming that the problem of the selection of qualified authorities is set aside, there is little dispute that a committee of such experts is positioned to command the best scientific (theoretical) knowledge available. However, this is neither the sum total of the knowledge that exists in society at any time nor is it necessarily the most important for the problem of the adaptation of economic plans to changed circumstances: “there is beyond question a body of very important but unorganized knowledge which cannot possibly be called scientific in the sense of knowledge of general rules: the knowledge of the particular circumstances of time and place. It is with respect to this that practically every individual has some advantage over all others because he possesses unique information of which use can be made only if the decisions depending on it are left to him or are made with his active cooperation” (Ibid., 80; italics added). Thus, the solution to the economic problem depends on whether we are more likely to convey to a central committee of suitably-chosen experts or to

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6 Hayek wrote a decade earlier regarding the difficulties of discovering such experts: “when the state is invoked...virtual omniscience is often ascribed to it in contrast to the limited entrepreneur. But the state...[is] made up of human beings, and, if there really were such omniscient human beings then there would be every reason to assume that they would also figure among the most successful entrepreneurs. It must seem more than doubtful whether a mechanism for selection exists which ensures that it is precisely the most capable who are put at the top of an economic administrative apparatus” (Hayek [1936] 1984, 164-165).
dispersed individuals such additional information as each requires to adjust their respective economic plans “into the whole pattern of changes of the larger economic system” (Ibid., 84).

Knowledge of changes in the circumstances of time and place is especially important to the timely adaptation of economic plans to these changes (Ibid., 83). Moreover, beliefs about general rules require less frequent revision than do beliefs about particular circumstances (Ibid., 82). Thus it is that the knowledge mostly likely to be possessed by well-placed individuals as regards the particular circumstances of time and place is especially important to the tendency toward equilibrium.

However, it does not follow from this that the adaptation of economic plans to changed circumstances is most effective under a system of decentralized planning. Two questions remain: 1) how is it that information regarding circumstances outside their immediate purview is communicated to individual plan-makers? And 2), does the method of communicating information regarding changes in the particular circumstances of time and place to a committee of suitably-chosen experts actually convey the knowledge required for effective adaptation of economic plans?

Hayek argues that the information required for an individual to adjust her plans to the circumstances of the broader economic system is limited to that concerning changes in the relative scarcities of the resources (and their substitutes and complements) that enter into her plan-making (Ibid., 84). It is the function of a freely-adjusting price system to communicate just this information. That is, an unfettered price system is an epistemological device: its main function (though not one for which it was deliberately designed) is to signal information regarding changes in beliefs with respect to the relative scarcity of economic resources. A freely-adjusting price system is a mechanism for the facilitation of human foresight (Ibid., 85-87).
Thus, the operation of the tendency toward equilibrium – as Hayek defines it, i.e., as a tendency for the foresight of plan-makers to become more correct – is facilitated by the presence of a freely-adjusting price system that communicates to dispersed individuals such information as they need to adjust their plans to changes in the circumstances of time and place that fall outside their immediate purview.

It is an implication of this equilibrium-facilitating aspect of the epistemological mechanism that is a freely-adjusting price system that anything that impedes the regular adjustment of prices to changes in particular circumstances ipso facto impedes the adaptation of economic plans to these circumstances and, thus, hinders the tendency toward equilibrium. The price system is less effective as prices grow more rigid (Ibid., 86). However, the price system facilitates the tendency toward equilibrium well enough\(^7\) in the absence of price rigidities.

This thesis is made relevant to the problem of industrial fluctuations by the negative answer Hayek offers to the second question posed above regarding the possibility of communicating to a committee of experts such information concerning changed circumstances as is necessary to adapt a centralized plan to these changes. Hayek’s justification of this negative response explains how, even in an economy in which planning is relatively decentralized, the price system can be – and, in his view, regularly is – prevented from effectively performing its epistemological function.

Macroeconomic management in an otherwise decentralized system of economic planning requires deliberate manipulation of the price system, which, however, cannot (in the absence of preternatural luck) realize its goals because the economic statistics that are communicated to

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\(^7\) A freely-adjusting price system is not necessarily an instantaneously-adjusting, or even a rapidly-adjusting, price system. The standard against which the operation of the price system in the real world is to be judged is not the perfectly competitive system of the economist’s imagination, but an economic system sans a freely-adjusting price system (Hayek [1946] 1948; [1961] 2014).
policymakers do not convey any knowledge that is relevant to the effective administration of economic equilibrium. The statistical method abstracts from differences between particular resources with respect to “location, quality, and other particulars” (Hayek [1945] 1948, 83). Knowledge of these differences is relevant to an understanding of the state of the economy, as is knowledge of the connections between the various elements that give rise to such a complex structure. “Statistics, however, deals with the problem of large numbers by eliminating complexity and deliberately treating the individual elements…as if they were not systematically connected” (Hayek [1964a] 1967, 29).8

According to Hayek, economics, like evolutionary biology (Hayek 1967, 76), but unlike Newtonian mechanics, studies systems of complex phenomena (Hayek [1955] 1967), which Hayek defines as systems of a large number of elements interrelated both to each other and the external environment in such a way as to give rise to an emergent structure possessing “certain general or abstract features which will recur independently of the particular values of the individual data, so long as the general structure…is preserved” (Hayek [1964a] 1967, 26).

Different sets of individual elements may manifest the same emergent order provided the relevant interrelations remain stable; and the same elements may fail to give rise to an identical order if these interrelations are not maintained (1967, 68).

The scientist of complex phenomena investigates the emergence of these irreducible properties. Our knowledge of such systems is necessarily constrained relative to our knowledge of comparatively simple systems like those of Newton’s mechanics. The number of elements of such complex systems is so large as to limit our ability to populate theoretical models with data

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8 See also Hayek ([1961] 2014): “Information about aggregates or statistical collectives is of little use for deciding what particular people should do at particular moments which is what they would have to be told by the central authority. The statistician, in order to arrive at his aggregates, must largely abstract from those very details which will decide what particular individuals ought to do.”
sufficient to generate any but drastically circumscribed predictions (Hayek [1955] 1967, 19; [1964a] 1967, 27). Moreover, because it is the interactions between the elements (and their interactions with the environment), rather than any properties of the elements in isolation, which are crucial to the order that emerges, neither the present state of such an order can be known nor its future state predicted on the basis of a sampling of the elements.

It is impossible to populate Hayek’s theoretical conception of the economy as a complex system coordinated by the price system with sufficient empirical data because many of the relevant variables and interrelations that give rise to a particular economic structure “will hardly ever be fully known or measurable” (Hayek [1975] 1978, 24). We cannot measure the extent of the present dis-coordination prevailing in people’s beliefs relative both to each other and to external circumstances. At any given time, we cannot know what we do not know at that time. However, knowledge of this sort is required if economic management is to be effective; that is, if the policymaker is to craft policy so as to effectively transform a state of economic disequilibrium into its opposite, she must possess reasonably accurate knowledge of the present state of the economy: she must know the extent to which prevailing beliefs are uncoordinated and inaccurate. However, such knowledge of the current state of the complex system that is a national economy cannot be conveyed to economic policymakers. Thus it is that the deliberate political maintenance (or restoration) of economic equilibrium requires knowledge unavailable to macroeconomic policymakers: the knowledge that is available is not relevant and the relevant knowledge is not available.

However, this conclusion is typically denied by those “who have hoped that our increasing power of prediction and control, generally regarded as the characteristic result of scientific advance, applied to the processes of society, would soon enable us to mould society
entirely to our liking” (Hayek [1975] 1978, 30). Moreover, the attitude of the public toward these same possibilities for social-scientific prediction and social control exacerbates the politician’s penchant for denying her manifest ignorance: “so long as the public expects more there will always be some who will pretend, and perhaps honestly believe, that they can do more to meet popular demands than is really in their power” (Ibid., 31).

To make matters immeasurably worse from Hayek’s perspective, this misplaced optimism is sanctioned by the prevailing, if mistaken, opinion regarding proper scientific method. “[T]he confidence in the unlimited power of science is only too often based on a false belief that the scientific method consists in the application of a ready-made technique, or in imitating the form rather than the substance of scientific procedure” (Ibid., 30). According to the fallacious “scientistic” methodology that holds sway over many macroeconomists, their political advisees, and a large swath of the latter’s public constituency, “often that is treated as important which happens to be accessible to measurement” (Ibid., 24). Scientism elevates the sciences of simple phenomena to the level of exemplars for all other fields to follow. The methods of these disciplines – particularly their quantitative techniques – are to be applied in all areas of scientific inquiry including those that investigate the complex phenomena of society. In virtue of its quantitative nature and its very successful application in the sciences of simple phenomena, the statistical method appears the quintessence of science. In acting on the basis of such data, policymakers are misled into believing that they act on the basis of knowledge relevant to their task.

9 See also Hayek ([1961] 2014): “The suggestion that there may be limits to what science can achieve is generally not well received today. It is not only regarded as the expression of a defeatism unwarranted in view of the incredible conquests which science is making every day, and as a prediction of a kind which has been disproved in the past in so many instances as to have lost its plausibility. It is even considered as outright unscientific, because only experience can show what science can and what it cannot do.” Of course, as Hayek was well aware given his familiarity with the arguments of Peirce and Popper, one of the things that experience has shown that science cannot do is establish infallible truths.
What’s more, the scientistic precept that any theory for which quantitative evidence is adducible must be superior to one for which such evidence is unavailable contributes to an undue focus on the former variety of theory. Indeed, there is a theory according to which the economically important variables just happen to be measurable, i.e., the (Keynesian) theory that “consists in the assertion that there exists a simple positive correlation between total employment and the size of the aggregate demand for goods and services [which] leads to the belief that we can permanently assure full employment by maintaining total money expenditure at an appropriate level” (Ibid.).

In short, blinded by a false methodology, the economic policymaker is led into a “pretence of knowledge” upon which she acts, unawares – indeed, convinced otherwise – of the irrelevance and inadequacy of her epistemic position. More carefully, policymakers are misled into the false belief that they possess both the theoretical and empirical knowledge required of effective macroeconomic management by the combination of a methodology that accords special importance to measurable parameters and a theory that makes the relevant variables those that just happened to be measurable. When policymakers pretend to possess the relevant economic knowledge and make policy – which typically requires price manipulation – on the basis of this pretence, they impede the price system’s knowledge-coordinating function (Ibid., 34). It suffices to impede the operation of the tendency toward equilibrium for those in a position to do so to set prices on the basis of knowledge that they don’t in fact possess.

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It is not necessary in the present context to recapitulate the details of Hayek’s early business cycle theory. What is important for our purposes is that at its most fundamental level the early account attributes the cycle to particular instances of price setting in the presence of ignorance. More carefully, Hayek’s early account explains economic disequilibrium in terms of the discombobulating effect that credit expansion has on the delicate links between consumption and production decisions. Credit expansion – a supply of bank loans that exceeds the supply of voluntary savings or, in Hayek’s technical verbiage, a rate of interest on loans below the “natural” rate of interest that equilibrates the demand for loans with the supply of voluntary savings – prevents the re-adjustment of the economy to changes in the economic data:

“(t)he situation in which the money rate of interest [on loans] is below the natural rate need not…originate in a deliberate lowering of the rate of interest by the banks. The same effect is obviously produced by an improvement in the expectations of profit or a diminution in the rate of saving, which may drive the ‘natural rate’ (at which the demand for, and the supply of, savings are equal) above its previous level; while the banks refrain from raising their rate of interest to a proportionate extent, but continue to lend at the previous rate, and thus enable a greater demand for loans to be satisfied than would be possible by the exclusive use of the available supply of savings” (Hayek [1933] 2008, 78).

The latter case is important, not only due to the fact that it is “probably the commonest in practice, but to the fact that it must inevitably recur under the existing credit organization” (Ibid.; italics in the original).

Hayek proceeds to show that the inevitable recurrence of this case is a consequence of bankers’ ignorance of the data necessary to ensure equality between the loan and natural rates of
interest. The question is whether expansion of the money supply by the banking system “may not take place automatically under certain conditions—without the necessity for any special assumption of the inadequate functioning of any part of the system” (Ibid., 79). Hayek argues that it is impossible for bankers to know whether they are at any time creating additional credit or lending on the basis of voluntary savings: “(a)s credit created on the basis of additional deposits does not normally appear in the accounts of the same bank that granted the credit, it is fundamentally impossible to distinguish, in individual cases, between” deposits based on savings and those that result from the granting of credit by other banks.¹⁰ With respect to any particular loan, the lending institution is typically not where the loaned funds are ultimately deposited (because the lendee either deposits the loan in another bank or spends the money with a merchant who deposits the funds in another bank) and, because incoming deposits aren’t dog-eared as either “savings-based” or “credit-based,” it is impossible for bankers at the deposit bank to know whether they are receiving (and subsequently lending on the basis of) savings or credit (Ibid., 87).¹¹ “[T]his consideration rules out, a priori, the possibility of bankers limiting the amount of credit granted by them to the amount of ‘real’ accumulated deposits” (Ibid.).

The essential point is that Hayek’s early theory postulates a particular instance of ignorance as a sufficient cause of economic disequilibrium. In order for the tendency toward equilibrium to operate, it is necessary that the loan rate of interest equal the natural rate of interest. However, under a fractional-reserve banking system such as obtains in all modern

¹⁰ See also Hayek ([1929] 1984, 192) where, in his review of Hans Neisser’s (1928) Der Tauschwert des Geldes, Hayek mentions with approval Neisser’s treatment of “the inseparability in principle of the cheque deposits that have originated from the deposit of cash and from the granting of credit.”

¹¹ Technically, the inevitable recurrence of credit creation is a consequence of ignorance plus the profit motive. That is, bankers are incentivized by profit considerations to push lending to the limits of their normal reserves and, actually, by dipping into their available reserves, beyond this limit (Hayek [1933] 2008, 87-94). However, the ignorance of bankers is the more fundamental point. That is, with or without the profit motive – i.e., even in a world in which bankers are entirely motivated by unadulterated altruism – so long as fractional-reserve banking is practiced, it is inconceivable that bankers can ensure equilibrium between voluntary savings and investment.
economies, it is impossible for this condition to obtain because bankers do not possess the knowledge required to realize it; so, bankers set loan rates – which, it must be recalled, are prices – without the benefit of the knowledge required to facilitate the operation of the tendency toward equilibrium.

Thus it is that, despite the differences in the theoretical frameworks in which they’re explicated – namely, the differences in their conceptions of equilibrium and the explicit role of capital and interest theory in the early account – Hayek’s explanations of industrial fluctuations are closely related in terms of the ultimate causes they adduce for economic disequilibrium. Both accounts attribute industrial fluctuations to inadequacies of human cognition, i.e., to the inaccessibility to human minds of particular items of relevant knowledge. More carefully, both accounts make the prime mover of the trade cycle a certain kind of human action, namely, price setting under a veil of ignorance of the knowledge required to make such action effective.

Hayek’s early account makes it the case that the economy cannot re-equilibrate because of credit expansion, which cannot be prevented because, in a system in which fractional-reserve banking is practiced, bankers are necessarily ignorant of the price of loans that would equilibrate lending with voluntary saving. Hayek’s later epistemic theory makes any kind of manipulation of prices a sufficient cause of episodes of disequilibrium. He adds to this theory an empirical claim of regular price interference, which he attributes to the ignorance of policymakers with respect to their own ignorance: policymakers interfere with the price system (in part) because they mistakenly believe they possess the knowledge to do so effectively.

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12 It is significant for the purposes of the present paper that, in his early cycle work, Hayek emphasizes the effects of credit creation upon the signaling – i.e., epistemic – function of the price system: “It is, of course, a well-known fact that the current supply of money-capital is not necessarily identical with the amount of current savings.…This means, however, that entrepreneurs will often base their decisions about their investment plans on a symptom which in no way indicates even the current willingness of the consumers to save, and therefore provides no guide whatever for a forecast of how they will distribute their income in the future between consuming and saving” (Hayek [1933] 1939, 144; italics added).
In both cases, it is the setting of prices on the basis of ignorance that impedes the
tendency toward economic equilibrium; indeed, *it is an implication of the later epistemic theory*
*that the actions of bankers under a veil of ignorance of the relevant data posited by the earlier*
*account will impede the tendency toward equilibrium*; however, it is not a consequence of the
earlier theory that price interference as posited by the later account will necessarily impede the
tendency toward equilibrium. This is to say that the later account is a broader, more general
explanation of fluctuations that includes the earlier account.

III. THE DEVELOPMENT OF HAYEK’S EPISTEMIC THEORY OF INDUSTRIAL
FLUCTUATIONS

The thesis of the present part of the paper is that the later epistemic theory is not only logically
related to the earlier technical-economic explanation of the cycle, but is also historically related
to the earlier theory. The three elements of the epistemic theory, i.e., the epistemic conception of
equilibrium, the treatment of the price system as a foresight-facilitation mechanism, and the
theory of complex phenomena with its concomitant pretence of knowledge explanation of
industrial fluctuations, all have their source either specifically in the early business cycle project
or in considerations contemporaneous and intimately connected with it.

*The Role of Equilibrium and Prices* *qua* Epistemic Concepts in Hayek’s Early Business
Cycle Project
For the intents and purposes of the epistemic theory of the cycle, Hayek resolved the problem of the equilibrium framework in 1937 with the argument of “Economics and Knowledge” to the effect that economic equilibrium is less about supply and demand than it is about market participants’ beliefs about conditions relevant to supply and demand. This conception left unexplained the fact – and Hayek took it to be an empirically-obvious fact – that modern economic systems exhibit a tendency toward equilibrium. Hayek resolved this difficulty with the argument of “The Use of Knowledge in Society” (1945) that prices provide the signals necessary for economic agents to adjust their respective plans to the ever-changing circumstances of time and place.

However, these epistemic considerations did not emerge ex nihilo. As can be seen in the 1933 essay “Price Expectations, Monetary Disturbances, and Malinvestments” ([1933] 1939), Hayek’s thinking about both equilibrium and the price system as epistemic concepts predates the better-known treatments of 1937 and 1945 by several years and, crucially for our purposes, is linked directly to his early business cycle project. In this paper, Hayek restates the concept of the equilibrium (or “natural”) rate of interest in terms of an epistemic conception of economic equilibrium, thereby countering Gunnar Myrdal’s (1933) criticism to the effect that the theory of Prices and Production ([1931] 2008; hereafter PAP) ignored considerations of foresight and entrepreneurial expectations. Given this new epistemic concept, Hayek ([1933] 1939, 144-148)

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13 In truth, it seems that Hayek never fully resolved his ambivalence toward the heuristic metaphor that is the equilibrium concept. On at least one occasion later in his life, Hayek conceived of a capital-using economy in terms of the metaphor of a system of streams or rivers, but even this emendation seems to have left him unsatisfied (Caldwell 2004, 226-227).
14 “Experience shows us that something of this sort does happen, since the empirical observation that prices tend to correspond to costs was the beginning of our science” (Hayek [1937] 1948, 51).
15 Indeed, one can read Hayek’s 1928 article “Intertemporal Price Equilibrium and Movements in the Value of Money” as concerned with an equilibrium of expectations and, thus, with an epistemic conception of the equilibrium construct: “to enable the use of equilibrium analysis, it is only necessary to assume, as we have done, that no deviation from the expected course of events takes place during the period” (Hayek [1928] 1984, 85; italics added; see also Ibid., 87)
shows the crucial role that expectations play in the theory of the cycle described in *PAP*. More carefully, and most interesting for our purposes, Hayek shows how certain distortions of the price system – he’s still thinking of bankers’ inability to maintain loan rates in line with the equilibrium rate – can, *in virtue of the epistemic function of prices*, give rise to expectations that are bound to be disappointed and thereby to all of the well-known phenomena of economic disequilibrium:

> “It is [clear] that expectations existing at a particular moment will to a large extent be based on prices existing at that moment and that we can conceive of constellations of such prices which will create expectations inevitably doomed to disappointment, and of other constellations which do not bear the germ of such disappointments and which create expectations which—at least if there are no unforeseen changes in external circumstances—may be in harmony with the actual course of events. This consideration appears to me to provide a useful starting point for further developments of the theory of industrial fluctuations.” (*Ibid.*, 140-141).

In short, the epistemic treatments of both equilibrium and the price system are artifacts of Hayek’s early business cycle project.

**The Complexity of Hayek’s Early Business Cycle Project**

The present section is concerned with those (“internal”) aspects of Hayek’s early theory that eventually persuaded him not to persevere in this approach to the problem of industrial
fluctuations.\textsuperscript{16} Prime among these reasons seem to be considerations of the sheer intricacy of the theory he had developed and the realization that the theory was not nearly complicated enough to express the complexity of the phenomena under investigation. Theorizing about the dynamics of capital, money, and the cycle in the way that Hayek had done theretofore meant either constructing an overly simplified theory which, given the complexity of the phenomena, would be “probably of necessity false” (Hayek [1964a] 1967, 28) or developing a highly elaborate theory – like the one Hayek constructed in The Pure Theory of Capital – “so damned complicated it’s almost impossible to follow it” (Hayek 1994, 141).

Hayek’s earliest writings\textsuperscript{17} aimed to clarify the foundations of the theoretical framework upon which he built the trade cycle theory exposited in the companion pieces Monetary Theory and the Trade Cycle ([1933] 2008; originally published in German in 1929; hereafter MTTC) and Prices and Production. Hayek was aware that Walras’ static general equilibrium framework was an imperfect tool upon which to build a theory of the cycle in a dynamic, money- and capital-using economy (Hayek [1928] 1984). Nonetheless, when he came to consider the methodology of cycle theories in MTTC, he argued that the goal of unifying an explanation of the cycle with the then-existing corpus of economic theory required the Walrasian framework (Hayek [1933] 2008, 18-19). The uniqueness of Hayek’s early theory lies in the fact that, with the introduction

\textsuperscript{16} To say that we’re concerned with the internal reasons that led Hayek to abandon his business cycle project is to say that we’re not going to consider the contemporaneous considerations external to the theory itself that also contributed to its desertion. Such “external” reasons include the fact that, by the time of the publication of The Pure Theory of Capital in 1941 after a long gestation period, Hayek was not only distracted by other interests, particularly the so-called “Abuse of Reason” project that produced The Road to Serfdom ([1944] 1994) and The Counter-Revolution of Science (1952b), but was also drained of all enthusiasm for completing the project, which would have required marrying his capital theory with monetary theory in a business cycle account far more complex than the comparatively simple explanation of PAP. Hayek hoped, however, that others would take up the challenge. For reasons bound up both with lack of support in the wake of the Keynesian onslaught and the very complexity of the project, this never happened. On these and related matters, see White (2007).

\textsuperscript{17} Some, but not all, of these essays have been translated and anthologized in Hayek (1984)
of assumptions concerning money and the activities of bankers in the creation of credit, cyclical fluctuations can be generated out of the otherwise perfectly-adjusting equilibrium framework.

However, in the “Price Expectations” essay of 1933, Hayek argues against this view that the superimposition of monetary assumptions upon the skeleton of Walrasian equilibrium suffices to generate an adequate explanation of the cycle; this latter method is “to press the problems into the strait-jacket of a scheme which does not really help to solve them” ([Ibid.], 136). Instead, what is needed is “a development of our fundamental theoretical apparatus which will enable us to explain dynamic phenomena…I am now more inclined to say that general theory itself ought to be developed so as to enable us to use it directly in the explanation of particular industrial fluctuations” ([Ibid.], 137-138).

Hayek employs his epistemic concept of equilibrium throughout *The Pure Theory of Capital*, but “repeatedly apologizes for doing so. Although he clearly considers the new definition to be an advance over those found in earlier models, he also suggests that equilibrium analysis in general is, at best, *preparatory* to a more advanced causal analysis of economic phenomena” (Caldwell 2004, 224; italics in the original; see also Chapter Two of Hayek [1941] 2007, 31-51). Hayek’s epistemic treatment of equilibrium, more complex though it was than the traditional treatment, was ultimately still too simple for adequate technical-economic analysis of the phenomena of capital.

*Prices and Production* places Böhm-Bawerk’s theory of capital at the heart of an explanation of industrial fluctuations. It was this aspect of Hayek’s early cycle theory and especially Böhm-Bawerk’s concept of the “average period of production” – a measure of the temporal length of the capital structure – that was to receive the harshest criticism from both Hayek and his peers in the years immediately following the book’s publication. An average
period of production can be non-circularly defined only under severely restricted assumptions. When these conditions are relaxed, the definition of the average production period becomes circular in that it both depends upon and is a determinant of the interest rate (Hayek [1936] 2008, 497-498; White 2007, xxii).

Hayek came to believe that, though Böhm-Bawerk’s theory of capital was “essentially right and even…indispensable for a more detailed analysis” of industrial fluctuations, the capital theory upon which the analysis of PAP was founded was too simple: “I can see in the simplified form in which I had to use it in my former book it may be more misleading than helpful” (Hayek 1939, 7; quoted in White 2007, xxii). Hayek dedicated the better part of the 1930s to reconstructing the Austrian theory of capital so as to make it a more appropriate basis for an explanation of the cycle.

For our purposes, the most important aspect of the result of that reconstruction – The Pure Theory of Capital – is Hayek’s own reaction to it. The book’s preface is little more than an apology for both the complexity and the inadequacies of the theory stated in the main text. The theory of PAP was intended to be – and, indeed, given the circumstances of its rushed preparation, could only be – a mere sketch of an elaborated explanation of the cycle.18 Yet, as it became clear to Hayek that the simplifications of PAP, especially with regard to the temporal element embodied in the period of production concept, “evaded so many essential problems that the attempt to replace it by a more adequate treatment…raised a host of new questions which had never been really considered and to which answers had to be found[,]” Hayek was unable to proceed immediately to this more detailed account of the cycle. The consequences of certain of the simplifications of PAP could not be ignored: “the difficulty and complexity of the problems

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involved make a systematic treatment of these questions very necessary” (Hayek [1941] 2007, 4).

However, Hayek perceived the flaws of The Pure Theory of Capital to lie – despite its considerable complexity – “in the fact that…it leaves some problems of real importance unsolved” (Ibid.). Though “[i]t would be highly desirable…that this should be done once and for all…I can only plead that I have grappled honestly and patiently with what even now appears to me to be by far the most difficult part of economic theory, and that the present book with all its shortcomings is the outcome of work over a period so prolonged that I doubt whether further effort on my part would be repaid by the results” (Ibid., 5). The upshot is that the limited discussion of the trade cycle such as it appears in the fourth part of The Pure Theory remains “condensed and sketchy” (Ibid.) despite the fact that an elaboration of an improved theory of the cycle was the original motivation for writing the book!

In an effort to defend the original cycle theory of PAP from the criticisms directed at its capital-theoretic core, Hayek expounded a theory that was ultimately too complicated to serve as the basis of an extended explanation of cyclical phenomena and yet, at the same time, was too simple an explanation of the phenomena of capital. Plainly stated, it seems that Hayek’s early business cycle project failed to bear the theoretical fruit Hayek expected of it because the phenomena it considered proved too complex for the tools available for their analysis. Hayek had taken these tools as far as he could – which may have been as far as they could have been taken by anyone – but not far enough to complete the capital theory project, much less the elaborated theory of the cycle.
The Instrumentality of Hayek’s Business Cycle Project to the Development of the Theory of Complex Phenomena

Given what was said in the last section about the failure of Hayek’s early business cycle project in virtue of its inadequacy to reflect the complications of capital phenomena despite its massive complexity, it might seem a simple matter to link Hayek’s theory of complex phenomena directly to the failure of his business cycle project. Unfortunately, such a link is not so easily established. A span of nearly fifteen years separates *The Pure Theory of Capital* from Hayek’s first writings on the theory of complex phenomena and there is no place in the development of the latter theory where Hayek specifically claims to be merely picking up a thread left frayed by the failure of the early project.

However, the two projects are implicitly linked in Hayek’s “Kinds of Rationalism” ([1964b] 1967, 91). In this paper, Hayek takes to task those (constructivist rationalists) who fail to recognize the existence in society of complex (spontaneous) orders that emerge from the interplay of the environment, abstract rules that are often implicit and not capable of discursive statement, and the activities and interactions of individuals who, perhaps without consciously recognizing it, are guided by such rules. As a consequence of their failure to acknowledge the existence of these spontaneous orders, constructivists persist in the false belief that the processes of society are capable of the same deliberate manipulation for particular ends as the comparatively simple phenomena of mechanistic physics.

According to Hayek’s reminiscences in “Kinds of Rationalism,” the source of these considerations is “Economics and Knowledge” (*Ibid.*). However, as we have seen, the argument of “Economics and Knowledge” has its roots in the “Price Expectations” paper of 1933 written in response to Myrdal’s criticism of the absence of explicit considerations of entrepreneurial
expectations in *Prices and Production*. Thus, a line can be drawn from the latter book to Hayek’s response to Myrdal in “Price Expectations, Monetary Disturbances, and Malinvestments,” which laid the groundwork for the argument in “Economics and Knowledge,” which led via a rather circuitous route (“through a re-examination of the age-old concept of freedom under the law, the basic conception of traditional liberalism, and of the problems of the philosophy of law which this raises” (*Ibid.*, 92)) to Hayek’s later writings concerning complex phenomena and the methodology appropriate to their investigation. What’s more, the epistemic concept of equilibrium found in “Economics and Knowledge” is part of the foundation of *The Pure Theory of Capital*; so, given that the argument of the former grounds Hayek’s methodological arguments concerning theories of complex phenomena, the latter are connected to the early business cycle project in virtue of this association.

But we can go deeper than this. Hayek developed theories of complex phenomena long before he had explicit arguments concerning their nature and, indeed, before he even commenced his business cycle project. Hayek’s very first academic paper, written in 1920 when he was still a student at the University of Vienna, presents (what he would subsequently call) an “explanation of the principle” that gives rise to human consciousness (Hayek [1920] 1991). Theories of complex phenomena are limited to such explanations of the principle and the young Hayek, although he lacked the phrase to denote such explanations, was aware that his account of consciousness could neither support a full explanation nor make predictions of particular consciousness events:

“If I have succeeded in making the process of consciousness…comprehensible, the next task will be to classify the immensely rich material that science has collected about the

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19 The paper remains unpublished in English as of this writing though it is included in the German edition of *The Sensory Order* (see Hayek 2006).
development of consciousness according to the principle underlying this process. It will then be possible, as Wundt expresses it, to fulfill ‘the only task which psychological theory can tackle with any hope of success, a synthetically presented developmental history’. Yet, *it will have to be not an actual history of the development but only its theory for such a history, a schema for the development of all consciousness processes, which allows one to grasp the essence of each individual process*” (Ibid., 35-36; italics added)

The developmental history of consciousness will not be an *actual* history: it will not explain (or predict) how any particular consciousness event arises on the basis of the principle underlying the process in conjunction with relevant initial and marginal conditions; we do not (and cannot) know these latter conditions. All we can possess is an explanatory schema that allows us to understand how all consciousness events arise on the basis of the same underlying principle.

Thus, the fact that there is a methodological distinction to be made between theorizing about complex phenomena and about simple phenomena is implied (albeit underemphasized relative to its central place in his later work) in Hayek’s writings going back to his first academic work. However, more important for our purposes is the fact that Hayek came to think of his early business cycle account as an *instance* of a theory of complex phenomena. This follows straightforwardly from the fact that Hayek came to treat all economic phenomena as complex in the relevant sense ([1964a] 1967, 34-36). If we bear in mind that the vast majority of Hayek’s early work in technical economics was directed at the problem of the trade cycle, then it strains the limits of plausibility to think that this project was not instrumental to the development of his thinking about theories of complex phenomena. One would have to believe that all but that part

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20 The quote is from Wilhelm Wundt’s (1911) *Grundzüge der physiologischen Psychologie*, vol. II, p. 641.
of economic theory with which he was most familiar and with which he had the most experience
qua theorist figured more prominently in the development of these ideas.

However, the argument that Hayek’s early business cycle work was instrumental to his epistemic theory of industrial fluctuations doesn’t end there. As I have argued elsewhere, the predictions that emanate from Hayek’s early business cycle theory in fact do not rise to the level of even pattern predictions. As Hayek defines them, pattern predictions are distinguished from predictions of particular events in virtue of an absence of empirical data which, were they available, could be plugged into the relevant theory in order to generate detailed predictions of particular events. However, the predictions of Hayek’s early business cycle account lack more than mere empirical data; indeed, all the data in the world will not get us from Hayek’s theory to predictions of specific cyclical events. There are theoretical gaps in Hayek’s exposition that separate his early business cycle account from the possibility of even pattern predictions. In particular, Hayek’s theory postulates nothing with regard to the temporal spans that separate the posited causes from their purported effects. In the absence of these temporal parameters (and other theoretical parameters unspecified by Hayek), the theory offers no guidance as to which phenomenal patterns qualify as instances of economic-cyclical processes.

A phenomenal pattern in which, say, over the course of a picosecond, unnaturally low interest rates lead to a boom that is reversed in the form of a bust is in principle possible on Hayek’s theory, but so too is a pattern in which such a cycle unfurls over the course of a geochronological eon. Presumably, the reader shares my intuition that the objects that can be

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21 Scheall (Manuscript)
22 The further theoretical gaps in PAP include, but are not limited to, a theory of what it means to maintain capital intact over time (one of the problems that Hayek subsequently attempted to settle on a number of occasions – see “The Maintenance of Capital” ([1935] 1939), “The Mythology of Capital” ([1936] 2008) and The Pure Theory of Capital – but which was never resolved to his satisfaction) and a theory of the bust or depression phase of the cycle, or as Hayek calls it, a theory of the “economics of decline” ([1932] 1984, 137).
non-arbitrarily classified as business cycles (or boom-bust cycles or industrial fluctuations, etc.) span longer than a picosecond and shorter than a geochronological eon. If this intuition is sound, then Hayek’s theory is not a tool for classifying cyclical patterns in economic phenomena. Without specified temporal parameters, empirical data alone will not bridge the distance between Hayek’s theory and predictions of particular events, i.e., predictions of the form if so-and-so occurs at time $t_1$, then such-and-such will occur at time $t_2$. Hayek’s early theory of the cycle does not issue pattern predictions as he conceived of them.

However, the foregoing argument is not intended as a criticism of Hayek, who was well aware of the fact that economists cannot (and should not try) to say sooths of a temporally-indexed variety. If not entirely arbitrary, any temporal parameters that might be appended to Hayek’s early theory could only be grounded upon inductive evidence of an especially weak variety and would be subject to continual revision on this basis. Indeed, the only reason for raising this argument in the present context is to emphasize that Hayek’s own theory of complex phenomena provides an explanation of the principle of the failure of his early business cycle project.

An important conclusion of Hayek’s later methodological arguments is that any attempt to theorize about complex phenomena using analytical tools which, though they may be appropriate for the study of simple phenomena, are inappropriate for the investigation of more complex processes is, if not bound to fail, at least unlikely to succeed. In other words, Hayek’s argument as applied to the complex social phenomena of scientific theorizing predicts that we should expect to observe patterns of failure wherever scientists apply to analyses of complex phenomena tools appropriate only for the analysis of simple phenomena.
The foregoing argument concerning the consequences of the absence of temporal parameters in Hayek’s early business cycle theory and the fact of the near impossibility of their non-arbitrary addition to the theory (not to mention Hayek’s difficulties with the other gaps in the theory) supports the hypothesis that the tools at his disposal were ill-suited to the analysis of the incredibly complex phenomena of the cycle. Hayek’s later methodology is connected to his early business cycle theory in that it explains the ultimate failure of the latter.

Connecting the Pretence of Knowledge to the Early Cycle Project

Perhaps the most obvious evidence that Hayek’s 1974 Nobel Prize lecture “The Pretence of Knowledge” and the ideas it contains are connected to Hayek’s early business cycle project is the fact that the argument is directed against the theoretical system of the rival with whose name Hayek’s early treatment of the cycle is most intimately associated in the popular and professional imagination. Although Keynes is not mentioned by name, it is clearly his system that Hayek has in mind when he says:

“The theory which has been guiding monetary and financial policy during the last thirty years, and which I contend is largely the product of…a mistaken conception of the proper scientific procedure, consists in the assertion that there exists a simple positive correlation between total employment and the size of the aggregate demand for goods and services; it leads to the belief that we can permanently assure full employment by maintaining total money expenditure at an appropriate level.”

That is, Keynes’ system contributes to the pretence that policymakers (can) possess the knowledge required to ensure full employment. Keynes conceived of the complex phenomena of the economy in terms of a mere handful of variables the data regarding which he apparently
assumed to be both known (or, at least, knowable) to, and effectively manipulated by, policymakers. However, Keynes’ system is at least as underspecified as Hayek’s in terms of missing theoretical parameters and, in any case, the available data are not relevant and the relevant data are not available.

There are further pieces of evidence that connect the argument of “The Pretence of Knowledge” to Hayek’s early business cycle project. Hayek raises both the issue of the complexity of cyclical phenomena and the problem of the unenviable epistemic position (i.e., the ignorance) of policymakers surprisingly early in the development of his early business cycle theory. Indeed, up until the time when he became focused on refining the equilibrium and capital-theoretic aspects of his explanation of the cycle, Hayek’s arguments were often explicitly directed against a pretence of knowledge of the requirements of adequate countercyclical monetary policy, namely, the widely-held belief that price stabilization was both necessary and

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23 See also Hayek ([1961] 2014): “the new macroanalysis both seemed to conform better to the predominant conception of the character of scientific procedure and to make more direct contributions to the problems of day to day economic policy, while the exact scientific character of the older microanalysis was always a little obscure, and its results significant mainly for the choice between alternative economic systems rather than problems of current policy.” Hayek refers three times to a “pretence of knowledge” in this paper, the first of four lectures presented at the University of Virginia’s Thomas Jefferson Center in the spring of 1961 (and now available in The Market and Other Orders, the fifteenth volume of The Collected Works of F.A. Hayek), more than a decade before his 1974 Nobel Prize lecture entitled “The Pretence of Knowledge.” It might also be mentioned that “Economics and Technology,” the third lecture in the 1961 Virginia series, presents a shockingly modern argument against the pretence of knowledge of effective methods of transferring technologies from more- to lesser-developed economies. In any case, the consequences of political action on the basis of inadequate knowledge figured in Hayek’s thinking for a long while.

24 “The correlation between aggregate demand and total employment…may only be approximate” (Hayek [1975] 1978, 25).

25 In point of fact, Keynes’ system is less specified than Hayek’s in that it lacks all of the same theoretical parameters, including those related to the passage of time between cause and effect, but also lacks a theory of the design, implementation, and administration of effective countercyclical policies which, were it available, would in any case be irrelevant to Hayek’s system. In other words, Keynes’ theory, given that it asserts that effective countercyclical policy is possible, which Hayek denies, needs a supplementary explanation that Hayek’s theory does not, i.e., a theory of how to design, implement, and administer countercyclical policy so as to make it effective in practice (on the assumption that Keynes’ theory is correct). The details of the foregoing argument are explicated in my “Slaves of the Defunct: The Epistemic Intractability of the Hayek-Keynes Debate” (see Scheall [Manuscript]).

It should be noted that Hayek was aware that the difficulties of explaining complex phenomena are not limited to those of an empirical nature. Theories of complex phenomena will often contain gaps (see Hayek [1956] 1967, 124). However, he failed to make explicit the obvious consequence that not even pattern predictions / explanations of the principle (as he defined them) will then be possible with respect to such phenomena.
sufficient to ensure equilibrium and that knowledge of the value of some price index or other 
together with the capacity for its indirect control via monetary policy) sufficed for the purposes 
of economic policymakers. As early as 1925, Hayek wrote that such a method “seeks to solve the 
problem under discussion in what is certainly too simple a fashion” ([1925] 1984, 18; italics added). In another article three years later Hayek wrote that any attempt to stabilize the general price level as indicated by some index brings about erroneous signals that undermine the 
epistemic function of the price system: such “monetary influences…hinder the establishment of the natural price structure” ([1928] 1984, 102).

In the 1925 paper, Hayek addressed the suggestion that “cycle barometers” might supply the knowledge necessary for effective countercyclical policy; but, though he considered them to be better tools than price statistics, concluded that “all the improved suggestions continue to run up against one fact: that the economic situation is not revealed by the movement of any one of the factors that they take as their indicator[.] Rather, it is…the relationship between the behavior of these factors in the individual sectors of the economy that reveals the situation” (Ibid., 20). There are not – indeed, cannot be – statistics that reveal these relationships: “[t]he comprehension of these statistics is faced with the problem that the usual dividing lines drawn between the sectors of the economy…do not always coincide with those demarcations which correspond to the theoretical categories that must be employed in the explanation of cyclical movements. Hence even the most precise production statistic cannot yield any reliable conclusion as to the way in which the emphasis is shifting between the production of goods [of different orders], and whether this relationship is in accordance with the capital accumulation actually taking place” (Ibid.). In other words, the tools available for the conveyance of information concerning the economy to policymakers are too simple to reflect the complex
relationships between economic factors: again, the available data are not relevant and the relevant data are not available.

We might also add by way of supporting the connection between Hayek’s early work and his later methodological views that the “Pretence” argument is closely related to two other projects with which Hayek was engaged in the 1930s and early 1940s – i.e., contemporaneously with the development of his early cycle project – namely, the English language socialist calculation debate 26 (Hayek [1935a] 1948; [1935b] 1948; [1940] 1948) and the “Abuse of Reason” project, especially his “Scientism and the Study of Society” (Hayek 1942-1944), to which he turned immediately upon the publication of The Pure Theory of Capital. Though of a different order of magnitude, the ignorance of those who try to conduct countercyclical policy on the basis of Keynes’ theoretical system is no different in kind from the ignorance that afflicts economic planners in a centrally-organized society. Policymakers in both cases are infected by the “scientistic” attitude: “the propensity to imitate as closely as possible the procedures of the brilliantly successful physical sciences…[S]ome of the gravest errors of recent economic policy are a direct consequence of this scientistic error” (Hayek [1975] 1978, 23).

IV. CONCLUDING REMARKS

I have argued that Hayek’s views concerning complex phenomena and the methods appropriate to their investigation imply an explanation of industrial fluctuations that includes (the substance, if not the method of) the more (in)famous theory of the business cycle that he developed in the

26 Vaughn (1999, 131n) argues that Hayek’s work on the cycle contributed directly to his argument in the socialist debate: “the problems of intertemporal equilibrium that he was addressing in his business cycle theory may well have stimulated his objections to the socialists’ too facile attempt to pattern new economic institutions on the Walrasian model. Hayek knew too well from his capital theory the difficulties in even defining an equilibrium position in a complex capital using economy over time to think ‘solving’ for equilibrium prices in the socialist commonwealth would be a simple matter.”
1920s and 1930s. I have argued further that the historical roots of the elements of the former lie in considerations relevant to the latter theory.

The arguments of the present essay would seem to indicate that those who find value either in Hayek’s business cycle theory or in his writings on complex economic orders, but not in both, are at best ignoring facets of Hayek’s thought that are relevant – philosophically and historically – to those aspects they deem worthy of esteem. If you insist that the “good” Hayek was born or died in medias res, then you’re ignoring either the historical connection to the work of his pre-naissance or the logical connection with his work in the (not-so-)sweet hereafter.

At worst, such authors are missing a (perhaps the) central methodological implication of the long arc of Hayek’s career. A consistent liberal is liberal even in his approach to science. Hayek was fond of quoting Charles Sanders Peirce’s “first rule of reason” (Peirce 1896-1899; Hayek adopts the rule as the epigraph of the “Politics” section of Studies in Philosophy, Politics, and Economics): “in order to learn you must desire to learn, and in so desiring not be satisfied with what you already incline to think, there follows one corollary which itself deserves to be inscribed upon every wall of the city of philosophy: Do not block the way of inquiry.” The application of (classical) liberal principles to scientific practice reveals a requirement for a degree of humility about one’s science and of tolerance for competing methods.

References


See Hayek ([1961] 2014): “as we move from the comparatively simple phenomena of inanimate nature to the increasingly complex ones of life and society, we may have to become more modest in our aims and be content with results which are much more limited in their predictive content than is the case in the physical sciences.”


