**Complexity, Policymaking, and The Austrian Denial of Macroeconomics**

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**Abstract:** Economists associated with the Austrian School of Economics are known to deny the value of macroeconomics as descended from the work of John Maynard Keynes and, especially, his followers. Yet, Austrian economists regularly engage in a related scientific activity: theorizing about the causes and consequences of economic fluctuations, i.e., the business cycle. What explains the Austrians’ willingness to engage in theorizing about the business cycle while denying the scientific import of macroeconomics? The present paper argues that the methodological precepts of the School, which have remained largely in place since Carl Menger first pronounced them at the start of the *Methodenstreit*, justify the kind of business-cycle theorizing that Austrians do and imply the limited scientific value of macroeconomics as descended from Keynes.

**Keywords:** Austrian Business Cycle Theory, Austrian macroeconomics, F. A. Hayek, Ludwig von Mises, John Maynard Keynes

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**Introduction**

On a common, if rather narrow, definition of the field, Austrian economists deny that macroeconomics has any positive scientific value. If macroeconomics is conceived not in terms of a broad analytical concern for the general functioning of the economy, but as a kind of theorising that uses the aggregative concepts and analytical framework developed by John Maynard Keynes and his various descendants, then Austrians do not domacroeconomics. On this definition, there is no uniquely Austrian method of macroeconomics and my task here is entirely negative: explain the Austrian denial of macroeconomics. On a more generous definition, however, Austrian economists are famous purveyors of macroeconomics. If macroeconomics encompasses more than Keynes and his methodological (if not necessarily theoretical or ideological) descendants – if it includes, in particular, the business-cycle theorising that dominated so much of economic science throughout the 19th and early 20th centuries – then there is an Austrian method of macroeconomics to explain. Part of my task, therefore, must be to distinguish the methodological aspects of business-cycle theorising, as Austrians do it, from those of macroeconomics proper, sufficiently well to explain why Austrians happily engage in the former, while angrily denying the value of the latter. From an Austrian perspective, what makes the sort of business-cycle theorising that they do legitimate, but macroeconomic methods as descended from Keynes impermissible?

**A Purely Methodological Explanation of the Austrian Rejection of Macroeconomics**

It is possible to answer this question in a strictly methodological way. Several of the central precepts of modern macroeconomics are direct opposites of the methodological rules that Austrians have followed since Carl Menger (1883) first sparked the *Methodenstreit* against the younger branch of the German Historical School in the 1880s.

Austrians are methodological *individualists* (see Chapter Four of Hayek 2010 [1952]). They contend that, as economic phenomena emerge from the actions of and interactions among individuals situated in particular social contexts, the only legitimate units of economic analysis are individuals. Austrians are also methodological *subjectivists* (see Chapter Three of Hayek 2010 [1952]). Human action is not decided by objective considerations. Individual human actors do not have epistemic access to the objective truth concerning circumstances relevant to their actions. Rather, they have subjective beliefs about these circumstances that, though they may be (and often are) mistaken, are in any case the ultimate wellspring of human action. Humans act, not because the world *is* a particular way, but because they *believe* it to be a particular way (Hayek 2014 [1943]).[[1]](#endnote-1)

Macroeconomic method, on the other hand, is collectivist and objectivist (Hayek 2010 [1952], Chapters Five and Six). Macroeconomics trucks in aggregated measures and means, like a nation’s Gross Domestic Product (GDP) and its average price level, that purport to express and explain objective economic reality. Austrian economists argue, however, that such aggregated figures are causally irrelevant to economic phenomena (Hayek 2014 [1975], pp. 363-364). They are not causally efficacious: they give rise to no interesting economic phenomena. True, their subjective reflections in the minds of individual actors may figure in these actors’ decision-making: what people subjectively believe about GDP or the Consumer Price Index (CPI) might enter into their respective plans of action, but the purportedly objective measures themselves are not the kind of things that can give rise to economic effects (Hayek 2012 [1931, 1935], p. 195). It is always people, never any aggregate or average, who labour and leisure, purchase and sell, produce and consume, and borrow and loan. Neither do the mathematical figures of macroeconomics necessarily express the economic effects of human action (Hayek 2014 [1975], p. 363). They are mere theoretical constructions and, like all such constructions, reflect the preferences of their designers. In order to construct a measure of, say, production in a national economy, choices must be made as to what to include and exclude. Different designers will make different choices. Thus, different measures, though perhaps called by the same name, will express different phenomena, none of which need be of economic interest. The supposedly objective measures of macroeconomics are, in the final analysis, products of the minds of social scientists (Hayek 2010 [1952], Chapter Five). ‘[I]n the social sciences often that is treated as important which happens to be accessible to measurement’ (Hayek 2014 [1975], p. 363). Like the proverbial drunk searching for the house keys he misplaced in an entirely different location, macroeconomists always look under the streetlamp because that’s where the light is best, even though the phenomena of interest – the keys! – are not to be discovered there.

From an Austrian perspective, the economist’s task is to trace the emergence of economic phenomena from the actions of and interactions among individuals that are prompted by these individuals’ subjective beliefs about relevant circumstances. Unless grounded in a micro analysis that accounts for the emergence of economic phenomena from the actions of and interactions among individuals (and, thus, from individuals’ subjective beliefs), the aggregated and, by pretence, objective measures of macroeconomics have no place in economic analysis.

This purely methodological explanation of the Austrians’ rejection of macroeconomics might be best summarized in the terms that Hayek developed in his later methodological writings (see esp. Hayek 2014 [1955], 2014 [1964], and 2014 [1975]). According to Hayek (2014 [1964], 260-262), *complex phenomena* are those that require a complex model consisting of many variables open to the effects of the environment. Naturally, as the number of variables required to adequately explain some phenomena increases, our ability both to cognitively trace in theoretical terms the interrelations among the phenomena these variables represent and to discover their empirical values at any given time – in other words, our ability to explain the phenomena – becomes more limited. Complex phenomena require models that respect this complexity and avoid the temptation to oversimplify the phenomena, i.e. to treat in terms of a few variables what can be adequately explained only in terms of many variables and their interrelations with each other, and the environment (Scheall 2019). In particular, scientists of complex phenomena must be less ambitious in their explanatory aims than scientists of simpler phenomena explicable in terms of comparatively few variables in a closed system can afford to be (Hayek 2014 [1975], pp. 371-372). *Explanations of the principle* that account for the mechanism whereby the phenomena of interest emerge from their individual causal factors, even if this means that specific manifestations of the phenomena cannot be fully explained (Hayek 2014 [1955], p. 203), and *pattern predictions* that describe broad patterns to be observed in the phenomena but not specific events (Hayek 2014 [1964], pp. 259-260) are the just-practicable objectives of the sciences of complex phenomena. From this perspective, individualism and subjectivism are methods for frankly dealing with the complexity of economic phenomena, while collectivism and objectivism are methods for pretending this complexity does not matter to economic analysis.

**The Pretence of Macroeconomic Knowledge: Practical / Political and Psychological Aspects of the Austrian Denial of Macroeconomics**

Austrians insist that respecting the complexity of economic phenomena, acknowledging the explanatory and predictive limits of economic analysis, matters a great deal; and the reasons why it matters extend beyond purely methodological concerns (Hayek 2014 [1975]).

Social science has rarely, if ever, been done purely for its own sake. Political economists have always been interested in the practical significance of their theories for improving social conditions. Indeed, modern macroeconomics was born in the wake of the Great Depression (Keynes 1973 [1936]); its original *raison d'être* was practical. Austrians reject macroeconomic method less for any specifically scientific reasons than because they see it as ill-adapted to the practical – *political* – ends for which it is supposed to be a means, namely, the goal of maintaining and, in times of economic distress, improving, the health of the economy. Yet, even more troubling for Austrians than the deficiencies of macroeconomics as a countercyclical policymaking instrument *per se* is the way that these shortcomings are obscured by macroeconomics’ false façade of scientific respectability and the effects of this obfuscation on the psychologies of economic policymakers (Hayek 2014 [1975]).

By oversimplifying the complex phenomena of economics – that is, by treating phenomena the explanation of which require a model of many variables open to the environment in terms of a closed model consisting of a few variables – macroeconomic method imparts to the results of macroeconomic analysis an unmerited sheen of scientific virtue (Hayek 2014 [1975], p. 367). Together with the relative ease of measuring their variables, the oversimplified models of macroeconomics appear to place the economic policymaker in an epistemic position adequate to the tasks of effective countercyclical macroeconomic management. But, if there is anything to the Austrians’ methodological arguments, this is *mere* appearance; macroeconomic method manages no such epistemic feat (Hayek 2014 [1975] pp. 362-363).

In other words, the methods of macroeconomics, founded on a mistaken *scientistic* conception of scientific practice, deceive the economic policymaker into thinking they can manage the economy on the basis of their macroeconomic knowledge. Macroeconomics is founded 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, as if one needed only to follow some cooking recipes to solve all social problems’ (Hayek 2014 [1975], p. 368).

Austrians contend that when policymakers act on this epistemic basis despite its manifest inadequacy, the consequences tend to be not merely benign, but cancerous to economic health. Austrians deny macroeconomics not merely because it is scientifically inadequate and practically ineffective, but because it warps the psychology of policymakers in a way that facilitates rather than forestalls economic distress. ‘If man is not to do more harm than good in his efforts to improve the social order, he will have to learn that in this, as in all other fields where essential complexity of an organized kind prevails [i.e., in all those fields that study phenomena the explanation of which require a model of many variables open to the environment], he cannot acquire the full knowledge which would make mastery of the events possible’ (Hayek 2014 [1975], p. 371). If economic policymakers are not to create more economic suffering than they mitigate, then they must learn that macroeconomics is not a cooking recipe for the mitigation of economic suffering.

**A Primer on Austrian Business Cycle Theory**

Austrian Business Cycle Theory (ABCT) is built upon the foundations of Carl Menger’s (1871) capital theory as extended by Eugen Böhm-Bawerk (1959 [1888]) and Swedish economist Knut Wicksell (1959 [1893], 1934), and later elaborated by Ludwig von Mises (1981 [1912]) and F. A. Hayek (2012 [1929], 2012 [1931, 1935], 2007 [1941]). According to the Austrian theory of capital, producing goods for final consumption proceeds over several time-consuming stages, from the initial input of original factors of production (labour and land), to the production and application of various intermediate capital goods, to the penultimate emergence of consumables and their ultimate consumption. At the beginning of this process (or intertemporal “production structure”) are stages of production remote in time from final consumption, e.g. research and development, mineral extraction, and production of the most durable capital goods, like plant equipment and commercial buildings. At the end of this structure of production are those stages near in time to the consumer, e.g. wholesale and retail operations. Goods pass through several stages before emerging from the process ready for consumption.

Importantly, Austrians conceive of capital goods as heterogeneous and of varying degrees of specificity, a conception that methodologically rules out any treatment of capital as an aggregate of homogeneous stuff (Hayek 2012 [1937]; 2012 [1939], pp. 223-226). Capital is not some lump of undifferentiated goods all uniformly applicable come what may to whatever production process. Some capital goods are relatively non-specific and can be used in many stages across the production structure. A Phillips-head screwdriver, for example, might be used both in mineral extraction and in retail operations. Other capital goods, however, are highly specific and applicable only to a unique stage of a particular production process. A computer program required to fabricate a kind of fastener specific to a particular model of earth-moving equipment might find no alternative use should the equipment manufacturer go out of business.

The temporal duration or “roundaboutness” of the production structure is directly related to its value productivity (Hayek 2012 [1931, 1935], p. 219), more value being producible in a longer than in a shorter length of time, other things equal. Of course, consumers prefer more value to less, but also prefer to wait a shorter to a longer time to consume. Thus, consumers face a tradeoff, i.e. whether to sacrifice time for more valuable consumption goods or valuable consumption goods for more time.

On the Austrian conception, the interest rate on bank loans plays an important part in coordinating economic decision-making across time (Hayek 1999 [1928]; 1995c [1931]). It is an indicator of the state of supply and demand in the market for loanable funds (Hayek 2012 [1931, 1935], p. 211). On the assumption that the supply of loans is the sum of that portion of their respective incomes that individual consumers have saved for future consumption, the bank rate of interest is a marker of the manner in which consumers are making the above tradeoff – it is an indication of their preferences for time over value, value over time – at any given moment. Other things equal, when the bank rate falls, it is a signal to producers that consumers have made relatively more of their savings available for future consumption, i.e. that consumers are prepared to wait longer for more value and, therefore, that producers can profitably extend the production structure further into the future by engaging in more roundabout and more productive production processes. Conversely, when the bank rate rises, it is an indicator that consumers have made relatively less of their savings available for consumption in a future period, i.e. that the tradeoff between value and time has shifted in favour of time and, thus, that producers will find more profit in less productive shorter-duration production processes.

On the demand side of the loanable funds market, investors prefer longer-term investments, other things equal, a simple implication of the standard model of cash-flow discounting. A lower interest rate increases the comparative value of any future cash flow; it indicates to investors that future cash flow will cover their immediate expenses and so, ceteris paribus, a lower interest rate encourages greater investment in stages on the remote end of the structure of production. Thus, on the Austrians’ (Wicksellian [1898]) interest theory, the bank rate serves to coordinate the savings and consumption decisions of wage-earners with the decisions of producers with regard to the production of goods in “higher-order” stages temporally remote from consumption versus the production of goods in “lower-order” stages near to consumption. The interest rate on loans ‘governs not only the level of investment but also the allocation of resources within the investment sector. […] As implied by standard calculations of discounted factor values, interest rate sensitivity increases with the temporal distance of the [...] stage of production from final consumption’ (Garrison 1996, 101).

Where the connection is intact between the bank rate, expectations concerning the profitability of investments in different stages of the production structure and consumer’s decisions to consume in the present rather than save for the future, the loanable funds market functions relatively smoothly, according to the theory. Consumers increase (decrease) their savings, meaning that they are prepared to wait longer (shorter) for more (less) value. The interest rate falls (rises), signalling producers that there is profit to be had in lengthening (shortening) the structure of production and, since the interest rate is an effective signal of future consumer demand in this scenario, the supply of consumption goods that eventually reaches market meets a commensurate demand.

Of course, individual producers are not omniscient. Profit expectations for particular investments sometimes disappoint. However, without some intervening factor that breaks the connection between the loan rate, profit expectations, and consumers’ decisions to consume in the present rather than save for the future, Austrians argue that there is no reason why many producers should all make such errors *en masse*, as they do when boom turns to bust during a typical business cycle.

ABCT holds that, in modern industrial economies, in fact, there is an intervening factor that disrupts the bank rate’s signalling function, namely, the elasticity of the money supply. On Wicksell’s (1898) theory, the rate of interest that equilibrates the supply of consumers’ voluntary savings with the demand for loans is the *natural rate of interest*. Other things equal, when the supply of loanable funds exceeds voluntary savings, as can happen only where the currency is elastic, the bank rate falls below the natural rate.

There is some disagreement within the Austrian camp whether exogenous interference on the part of bankers, typically, central bankers, to deliberately expand the money supply beyond available savings is necessary (it is undoubtedly sufficient) to force the bank rate below the natural rate – the view defended by Mises (1981 [1912]) – or whether the expansion of the supply of loans beyond the extent of voluntary savings is an endogenous consequence of modern banking practices in economies with elastic currencies – the view defended by Hayek (2012 [1929], 2012 [1931, 1935]). On Hayek’s view, an autonomous increase in the natural rate due to either improved profit expectations or a drop in voluntary savings, *if uncompensated by a commensurate increase in the bank rate*, bears the same effects as a deliberate lowering of the bank rate below the natural rate. This case is important, according to Hayek (2012 [1929], p. 123), not merely because it is ‘probably the commonest in practice, but [due] to the fact that it must inevitably recur under the existing credit organization.’ Expansion of the money supply can occur ‘automatically under certain conditions - without the necessity for any special assumption of the inadequate functioning of any part of the system’ (Hayek 2012 [1929], p. 124). In particular, it is not possible for bankers to know at any given moment whether their lending activities constitute the creation of new credit or the distribution of accumulated savings: ‘As 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 extension of credit’ (Hayek 2012 [1929], p. 131).

It is well to note the distinct implications of these competing Austrian visions for the complexity of both the postulated causes of the cycle and countercyclical policymaking. On Mises’s (1981 [1912]) view, at least in a world where a true gold standard is in effect, the cycle cannot be set in motion without a deliberate decision by (central) bankers to make loans available at rates below the natural rate. In order to avoid the cycle, consequently, central bankers need only enforce the gold standard and resist any political pressure to abrogate it; and private bankers need only resist any incentives to profit at the expense of their competitors by expanding their lending activities beyond the extent of voluntary savings. According to Hayek’s vision, on the other hand, there is no possibility of effective countercyclical policy (see especially the Fourth Lecture of 2012 [1931, 1935]). The impossibility of distinguishing bank deposits due to savings from those due to the credit activities of competing banks means that the natural rate of interest is a mere theoretical figure that is not discernible in practice. Even if this problem could somehow be solved (and all of the other assumptions underlying ABCT realised), however, it is not obvious that we would want to eliminate bank credit, which makes possible ‘a speed of development exceeding that which people would voluntarily make possible through their savings’ (Hayek 2012 [1929], p. 143). A policy that will effectively annihilate economic fluctuations can be bought only at the price of slower economic growth. More to the present point, there is some tension even within the Austrian camp concerning the degree of simplification appropriate to models of the complex phenomena of business cycles.

In any case, in both its relatively simple Misesian and comparatively complex Hayekian forms, when the supply of loans extends beyond the amount of savings made available by consumers for the purposes of future consumption, the rate of interest on loans no longer serves as a reliable signal to producers of consumers’ preferences for present versus future consumption. As in the case where all loans are financed by savings, when the interest rate falls, in keeping with the implications of cash-flow discounting, producers face a (ceteris paribus) greater incentive to invest in more remote stages of production; the structure of production is extended further into the future. As a consequence, land and labour are bid away from those stages near consumption and the owners of these resources receive an income fillip that other landowners and laborers do not receive. Indeed, as the prices of consumption goods rise as a result of supply restrictions due to the bidding away of resources from the near stages of production, everyone but the lucky owners of those resources bid away toward the remote end of the production structure is forced to consume less than they prefer. In other words, the owners of the factors of production receive an income boost financed out of the *forced savings* of everyone else (Hayek 2012 [1931, 1935]; 2012 [1932]).

As those who initially receive the new money spend it in various ways (and those who earn their incomes in related fields spend their newly increased incomes et cetera), the effects spread across the entire economy - eventually, everyone earns back some of their forced savings. However, importantly, there is no reason to think that, in this process of first losing and then recovering some of the income they would have preferred to consume in the first place, consumers have altered their preferred mix of consumption and savings in favour of more valuable consumption goods and less time. There is every reason to think they still prefer consumption goods in the relative near-term. Unfortunately, as it is following a shortfall of the loan rate below the natural rate, the extended production structure is set to deliver consumables at a more distant time in the future. The economic crisis has struck: If consumer demand is to be satisfied, many of these longer-term investments will have to be shut down and their non-specific capital goods re-distributed – a time-consuming process – to near stages of production.

ABCT explains economic disequilibrium in terms of the discombobulating effect that credit expansion has on the delicate links between the interest rate, the supply of and demand for loanable funds, and consumers’ preferences and producers’ decisions. Unless the relevant connections are re-established via some other equally effective knowledge-coordinating mechanism, producers will be led to make investments in various stages of the structure of production – that is, to either lengthen it or shorten it by engaging in more or less roundabout, and, therefore, more or less productive, production processes – that, unless preternaturally lucky, will not find a commensurate demand when the relevant consumption goods reach market and, thus, will turn out unprofitable.

**Austrian Methodology and Austrian Business Cycle Theory**

We understand, I hope, the methodological, practical, and psychological reasons why Austrians reject macroeconomics, narrowly construed. It remains to explain why, despite this rejection, Austrians engage in the historically and, to some degree, conceptually related practice of theorising about the business cycle. In what ways and to what extent does Austrian Business Cycle Theory exemplify the methodological precepts of theoreticism, individualism, and subjectivism that Austrians have always followed? How and how far does ABCT respect the complexity of business cycle phenomena? Finally, what is the significance of ABCT for countercyclical policymaking and the psychology of economic policymakers?

As noted in the first footnote above, the Austrians’ theoreticism is more pertinent to their denial of econometrics than to their rejection of macroeconomic methods as such. However, there is a concern somewhat related to theoreticism that figures in the Austrians’ rejection of the macroeconomic theory specifically developed by Keynes (1971a [1930], 1971b [1930], 1973 [1936]). Recall that, from an Austrian perspective, economic explanation requires not just a theory but a theory adequate to the complexity of the phenomena. In their famous debate, Hayek’s (1995a [1931], 1995b [1931], 1995 [1932]) main complaint against Keynes’ *Treatise on Money* ((1971a [1930], 1971b [1930]) was the inadequacy of the latter’s theoretical conception of *capital*,a conception not remedied in Keynes’ (1973 [1936]) later *General Theory*. Hayek argued that marrying Austrian capital theory to the other elements of Keynes’s system resulted in an account of industrial fluctuations that looked much like ABCT.[[2]](#endnote-2) In fact, however, capital figured in Keynes’s economic thinking hardly at all. From Hayek’s perspective, the crucial scientific difference between the two theories was that his theory incorporated capital, while Keynes’ theory did not.

Hayek (1995b [1931], p. 162-163) acknowledged that Austrian capital theory was incomplete and deficient in various respects, but, surely, he thought, some conception of capital – especially one that, whatever its other faults, was realistic in the sense of emphasizing the time-consuming nature of production and the heterogeneity of capital goods – was better than altogether ignoring whatever part capital played in the promulgation of cycles. If capital figured in causing economic fluctuations, Keynes’s theory would systematically neglect its significance. If capital theory had problems that needed to be resolved before it could effectively figure in an adequate explanation of the cycle, the proper response was to try to resolve these problems – which is precisely what Hayek attempted to do over the course of the next decade (see Hayek 2007 [1941]) – not to ignore them and proceed immediately to a concomitantly inadequate explanation of the cycle. Simply put, from an Austrian perspective, the proper response to the inadequacies of capital theory, such as it was in the early 1930s, was to further complexify the theory to better accord with the very complicated nature of the phenomena. Keynes, on the other hand, moved in the opposite direction, (over)simplifying his theory by removing capital from consideration.

At first glance, it might seem that ABCT fails to live up to the standards of the Austrians’ avowed commitment to methodological individualism. After all, the theory proceeds not from the subjective perspectives of flesh-and-blood individuals but from the (ex hypothesi) shared subjective beliefs and attitudes of abstract classes of persons, e.g., *consumers*, *savers*, *producers in various stages of the production process*, *entrepreneurs*, *borrowers*, *lenders*, *bankers*, etc. As methodological individualists, Austrians are typically portrayed as rejecting the aggregative methods of macroeconomics: ‘Mr. Keynes’s aggregates conceal the most fundamental mechanisms of change’ (Hayek 1995a [1931], 128). However, we can now see that, in fact, Austrians do not reject aggregation *per se*, but rather, aggregation at a level so high that the relevant causal factors are obscured. For Hayek and the Austrians, the important phenomena regarding the cycle – which Hayek (2012 [1929], p. 80) thought modern statistical methods had established conclusively – were *changes in relative prices (and, thus, profits) among different industrial sectors of the economy*. An appropriate theory of industrial fluctuations did not necessarily need to be fully disaggregated to the level of real flesh-and-blood individuals; rather, it needed to be sufficiently disaggregated to illustrate these changes in relative prices and profits, their causes, and their consequences. For this, it sufficed to proceed from classes of individuals hypothesized to share many relevant subjective beliefs and attitudes in common, which – in keeping with the Austrians’ methodological subjectivism – give rise to their actions in the economy. Put another way, there are rational limits to the need to complexify one’s theory in order to account for economic phenomena that are determined by the nature of the problem under analysis.

The difficulties of economic policymaking are part and parcel of ABCT (see esp. the Fourth Lecture of Hayek’s (1931) [2012] *Prices and Production*). Indeed, the natural rate of interest – the rate that would equilibrate the supply of voluntary savings and the demand for loans in a counterfactual world in which the currency is inelastic – is not a measurable figure. Under prevailing credit institutions, we do not know how to prevent the cycle. Much of the knowledge that the economic policymaker would need in order to use ABCT as an effective policy tool is not available. However, even were the natural rate of interest a known variable, this knowledge would hardly ease the policymaker’s task. ABCT (at least, Hayek’s version) implies that eradicating the cycle would require putting an end to bank credit. However, bank credit allows for more rapid economic growth. Thus, the policymaker confronts a difficult tradeoff that ABCT is impotent to decide: controlling the cycle means limiting the prospects for rapid economic growth, while promoting these prospects implies a relative inability to control the cycle (Hayek 2012 [1929], p. 143). Even if all of these difficulties could be resolved, however, it would not suffice for policymakers to maintain the bank rate of interest at the natural rate. The effectiveness of a policy of monetary neutrality requires that all of the conditions assumed by ABCT obtain, including the premises of the general equilibrium theory at its core, i.e. full price and wage flexibility, correct foresight, et cetera (Hayek 2012 [1931, 1935], p. 282). Where these conditions do not hold, frictions will impede the smooth and rapid adaptation of the price system to changes in the economic data that is assumed by equilibrium theory and which is necessary for a policy of monetary neutrality to be an effective tool of countercyclical economic policymaking (Hayek 2012 [1931, 1935], p 283).

As an attempt to come to grips with some massively complex phenomena, ABCT explains the principle that gives rise to, and predicts patterns to be observed in, business-cycle phenomena, but it does not aspire to a full explanation or a precise prediction of particular instances of the trade cycle. Indeed, an implication of the theory and the methodological principles upon which it is built is that such explanations and predictions are beyond the ken of cognitively limited human beings. Built upon the methodological principles of theoreticism, individualism, and subjectivism, as well as a profound appreciation of the limitations that complexity places on the possibilities for explaining and predicting, and, therefore, controlling via political means, business-cycle phenomena, there is little prospect that Austrian Business Cycle Theory could ever serve as a tool of political mischief, unlike the oversimplified methods of macroeconomics that encourage economic policymakers to pretend to knowledge they do not possess.

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1. Though it is only indirectly relevant in the context of a discussion of macroeconomic method, the Austrians’ emphasis on the importance of *theory* to economic explanation should also be noted (Hayek 2010 [1952], p. 134). Austrians insist – indeed, they were early defenders of the view, which later became commonplace in the wake of Thomas Kuhn’s (1962) *Structure of Scientific Revolutions* – that there is no such thing as brute, atheoretical, empirical observation. All sensory experience is mediated by theoretical considerations. Even the simplest, say, visual experience of a patch of red involves interpretation in terms of a theory that distinguishes red from other colors (and colors from other properties). Related to this, Austrians also deny that theories can be logically inferred from experience in any straightforward way (Menger 1883).

The practical significance of their *theoreticism* is opposition to historicist and inductive methods. Thus, this theoreticism is less apparent in Austrian attitudes to macroeconomics *per se* than in their rejection of econometrics. [↑](#endnote-ref-1)
2. For an interesting effort at synthesizing the Austrian and Keynesian theoretical frameworks while remaining mostly true to the methodological precepts of the Austrian School, see Garrison (2001). [↑](#endnote-ref-2)