Hayek On The Business Cycle

Hayek's principal investigations in economics concerned [capital](http://en.wikipedia.org/wiki/Capital_(economics)), money, and the business cycle. [Mises](http://en.wikipedia.org/wiki/Mises) had earlier applied the concept of [marginal utility](http://en.wikipedia.org/wiki/Marginal_utility) to the value of money in his [*Theory of Money and Credit*](http://en.wikipedia.org/wiki/Theory_of_Money_and_Credit) (1912), in which he also proposed an explanation for "industrial fluctuations" based on the ideas of the old [British Currency School](http://en.wikipedia.org/wiki/British_Currency_School) and of Swedish economist [Knut Wicksell](http://en.wikipedia.org/wiki/Knut_Wicksell). Hayek used this body of work as a starting point for his own interpretation of the business cycle, elaborating what later became known as the "[Austrian Theory of the Business Cycle](http://en.wikipedia.org/wiki/Austrian_Theory_of_the_Business_Cycle)". In his *Prices and Production* (1931), Hayek argued that the business cycle resulted from the [central bank](http://en.wikipedia.org/wiki/Central_bank)'s [inflationary](http://en.wikipedia.org/wiki/Inflation) [credit expansion](http://en.wikipedia.org/wiki/Credit_cycle) and its transmission over time, leading to a capital misallocation caused by the artificially low [interest rates](http://en.wikipedia.org/wiki/Interest_rate). Hayek claimed that "the past instability of the market economy is the consequence of the exclusion of the most important regulator of the market mechanism, money, from itself being regulated by the market process".

Hayek's analysis was based on [Böhm-Bawerk](http://en.wikipedia.org/wiki/Eugen_B%C3%B6hm_von_Bawerk)'s concept of the "average period of production"and on the effects that monetary policy could have upon it. In accordance with the reasoning later outlined in his essay *The Use of Knowledge in Society* (1945), Hayek argued that a monopolistic governmental agency like a central bank can neither possess the relevant information which should govern supply of money, nor have the ability to use it correctly.

Also in 1931, Hayek critiqued Keynes's [*Treatise on Money*](http://en.wikipedia.org/wiki/A_Treatise_on_Money) (1930) in his "Reflections on the pure theory of Mr. J. M. Keynes" and published his lectures at the LSE in book form as *Prices and Production*. Unemployment and idle resources are, for Keynes, caused by a lack of effective demand; for Hayek, they stem from a previous, unsustainable episode of easy money and artificially low interest rates.