RETHINKING TIME AND MONEY AT THE BEGINNING OF THE 21ST CENTURY

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I gratefully accept the editors’ invitation to present a few reflections upon Dr. Garrison’s *Time and Money: The Macroeconomics of Capital Structure*. Since other contributors to this special issue of the *Quarterly Journal of Austrian Economics* will critically discuss several aspects of the book, I will not offer an exhaustive and systematic overview of the book’s content. After offering a few preliminary remarks, I will immediately pass on to discussing in somewhat more depth two particular topics. One relates to what I consider to be one rather questionable way in which Garrison’s construction deviates from established modes of thought in Austrian economics; the other relates to Garrison’s somewhat unbalanced treatment of the Keynesian and Austrian paradigms, an aspect that I consider equally problematic.

Time and money constitute the blind spots of classical or standard economics. Acknowledging this fact and taking it as a starting point for a renewed reflection upon the themes and problems that were of central importance during the important interwar debates remain as important today as ever. The classical model was essentially one of barter. Keynes and Hayek had presented two related challenges to classical economics: the role of money and the role of expectations. Hayek had been clearly implying that Say’s Law applies only to the natural economy and not to the monetary economy. Garrison elaborates on an illuminating metaphor Hayek had suggested in this respect, namely that “money by its very nature constitutes a kind of loose joint in the self-equilibrating apparatus of the price mechanism which is bound to impede its working—the more so the greater is the play in the loose joint” (Hayek 1941, p. 408). As Garrison (p. 52) explains: “The Austrian theory of boom and bust, which presupposes an essential loose-jointedness,
identifies a systematic misallocation of resources that could not possibly characterize a tight-jointed system.”

Nevertheless, even as late as in his *Three Elucidations of the Ricardo Effect* Hayek (1978, pp. 165-78) had refrained from treating the intricate questions surrounding the role of expectations in any systematic or satisfactory manner—while all the time recognizing their crucial importance. 3 Garrison’s treatment of these questions is outstanding, however, and must be considered a highlight in the Austrian literature. For the first time, Hicks’s (1967) challenge is satisfactorily dealt with (pp. 76-83).

Hicks had objected:

Hayek’s model does engender a process; some kind of lag (or lags) must therefore be implicit in it. Where is the lag to be found? . . . If there are no lags in market adjustment, the time-structure of production is irrelevant to the Cumulative Process; for there will not be time, before equilibrium is restored, for the structure of production to be changed. What then was Hayek’s lag? (1967, p. 207)

In Garrison’s construction there is no lag between earning and spending. There is, however, some scope for the expansion of output in all stages of production. As Garrison (2001, pp. 71-72) points out, the tug-of-war between investors and consumers that sends the economy beyond its production possibility frontier pulls the Hayekian triangle in two directions, that is, the triangle is being pulled at both ends—by cheap credit and strong consumer demand—at the expense of the middle. But it is not strictly necessary to suppose that both tendencies are *not* taking place simultaneously, that is, there is no need to postulate the existence of a lag *in this sense*. The (limited) scope for increased output at all stages translates into the scope for misallocations *among* stages. There is a bias in the direction of investment that is directly related to the particular manner in which the new money is injected. Credit expansion implies an investment bias.

Nevertheless, it cannot be simply assumed, much less taken for granted, that in the face of a monetary expansion, an elasticity of expectations of zero will apply. In this sense, the market process may—and often will—entail the existence of a lag. Mises had already pointed out, responding to an objection by Lachmann, that “without fairly elastic expectations there can be no crisis of the Austro-Wicksellian type” (Mises 1943, p. 251).

Critics like Hicks (1967) had been assuming that, in the face of a monetary expansion, an elasticity of expectations of zero applies. On the one hand, Austrian theory can accommodate the insight that the answer to the question of whether and to what extent the elasticity of expectations with respect to the

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