

Hazlitt vs. Hansen
Differences in the Analysis of
The General Theory of Employment, Interest, and Money

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To Henry Hazlitt,
for his immense wisdom and insight into Keynes' erroneous doctrine.

Hazlitt vs. Hansen

Differences in the Analysis of *The General Theory of Employment, Interest, and Money*

Keynes' magnum opus, *The General Theory of Employment, Interest and Money*, revolutionized the way the mainstream perceives that market and economic activity. Aside from the mercantilists and socialists, Keynes for the first individual whose goal was to disprove the instability of the free market and subsequent need for an overarching governmental authority to maintain equilibrium. Prior to the General Theory many economists had a strong devotion to Say's Law and the belief that macro-overproduction can not occur. Keynes' primary role was to cast Say's Law asunder and usher in a new era of economic science; at the very least the latter was achieved. One of Keynes' most dedicated disciples, Alvin H. Hansen, wrote a concise summation of the General Theory in order to more readily deliver its message to educators and students. This summation has been heralded by many in the field as both insightful and masterfully structured. On the other hand, an Austrian economist, Henry Hazlitt, authored the most brilliant refutation of Keynes' *General Theory* to date, *The Failure of the "New Economics."* This analysis uncovered many of the underlying flaws and recurring fallacies present in the General Theory. *The Failure of the "New Economics"* is a line by line refutation of Keynes' magnum opus and finally brings the economic structural failures present in Keynesian theory to light. Both Hazlitt and Hansen had different goals in mind when writing their respective texts and each succeeded in their own right in delivering their message to the public. It is the goal of following paper to relate both texts and give the reader concise arguments defending and disproving Keynes' theories. In addition, the paper will look at the goals of each individual and analyze their works rhetorically. In a world that has experienced a surge in government intervention in the economy, it is important now, more than ever, to understand the primary arguments in favor and against laissez-faire capitalism and the free market.

Section I:

Chapter 2 of *The General Theory*: Postulates of the Classical Economics

A) Alvin H. Hansen's Position

Hansen begins this analysis by arguing that Say's Law was only valuable as a crude insight into the economic structure of the pre-Keynesian era. Say's Law was too rigid and narrow to be applied to the complexity of the modern market and it was Keynes' role to correct the flaws present in pre-great depression era economic science. The supposed failures of the fundamental laws prior to Keynes were

blamed on the the inability of Say's Law to be applicable to an ever expanding and intricate economy. Hansen does not lend any direct reasons why Say's Law should be dismissed and seldom delves into the Keynesian arguments against “orthodox-classical”¹ fundamental economic laws. Hansen states that prior to the *General Theory*, economists had an “orthodox-classical” mindset and Say's Law was generally accepted in the field of economic yet was “*incapable of coming to grips with reality.*” The primary weakness of these economists lay in their strong defense of Say's Law and their unyielding adherence to outdated economic theories. Various economists prior to Keynes had already begun to unravel the problems surrounding Say's Law and other fundamental “orthodox-classical” economic theories. The most significant contribution Keynes gave to the field of economics was the supposed refutation of the principle foundation of “orthodox-classical” economic theories, Say's Law.

According to Hansen, a series of economists² in the early twentieth century had already begun attacking and dismantling Say's Law. These economists had serious concerns with the idea that the free market has the ability to automatically stabilize. The proto-Keynesians argued that the market can not automatically stabilize and that overproduction would lead to recurring business cycles.³ Alfred Marshall, a 19th century economist, suggested that the cause of temporary market fluctuations may be directly attributed to the ratio of savings to income. The notion that there may be a negative outcome for the economy due to a positive change in the ratio of savings to consumption is the crux of Keynesian business cycle theory.

Hansen regularly speaks of full employment as if it were the goal of the economic system and that economic growth could only be maximized when all individuals are part of the labor force. Hansen cites Pigou⁴ as supporting the main view that the overall market tends toward wage equilibrium. Pigou

1. Throughout the *General Theory* Keynes uses this term to describe a wide variety of schools of economic thought. The methodology of each economic school varies significantly and it is fallacious to compare them all in such a manner. This is the beginning of the ambiguity present in both Hansen's and, more importantly, Keynes' discussion of economic science. As will be noted further into the paper, Keynes often times uses a specific term in application to a wide variety of significances.

2. These proto-Keynesians Hansen speaks of are predominately Hobson and Clark. These individuals had believed that the free market does not have the ability to maintain proper equilibrium and therefore, must be controlled by government authority in order to allow for stabilized production. One thing not mentioned in *A Guide To Keynes* is that Hobson and Clark has strong socialist roots and had believed that socialism, not capitalism, was the proper structure of the economic system. Hansen throughout *A Guide To Keynes* tries to remove the notion that Keynes had socialist leanings but fails as such information, such as Hobson and Clark's socialist ties, is brought out to light in other texts.

3. When writing on Say's Law, Hansen fails to draw the line between normal economic fluctuations and the business cycle. In this analysis, it is important to point out the difference between alterations in the relationship between demand and supply and problems in the overall state of the economy; Hansen falsely juxtaposes market fluctuations with depressions. In one instance, all industries are affected and in the other only a handful of industries experience an adjustment in capital to the expense of another industry. Market fluctuations *are* inherent to laissez-faire capitalism but it is fallacious to compare such occurrences with a macro-reduction in economic output.

4. Arthur Pigou was a 19th century British economist who studied under Alfred Marshall. An interesting work by Pigou on Keynes' *General Theory* is *Keynes's General Theory: A Retrospective View*.

believed that unemployment is non-existent in the long-term but relates short-term unemployment to significant recurring changes in demand. Pigou states that automatic market adjustments can be achieved through a flexible wage system to where changes in demand are not as detrimental to the short-run economy. Keynes, as Hansen shows, agreed that the marginal-productivity of workers and wage-rates are related and that unemployment is “*due to inadequate aggregate demand.*” Hansen argues that there are two weaknesses in the “orthodox-classical” approach to economics. These are “1) *rate of interest can be relied upon to adjust investment and savings so as to ensure (apart from temporary disturbances) full use of resources;* 2) *whatever the state of demand, wage adjustment will always (apart from temporary disturbance) ensure full employment.*”⁵

Hansen argues that Say's Law was only applicable to economies in which each individual created and sold their *own* output. In other words, Say's Law could only be used in the economic analysis of economies where the division of labor had not yet expanded. In the modern economy, the entrepreneur and the laborer are often times two different entities but in more primitive economies they were one in the same; hence, the laborer was the entrepreneur. In these primitive economies saving *was* investing yet in current economies these attributes are not always at equilibrium because the laborer is no longer the entrepreneur. This is the bulk of Hansen's remarks towards the invalidity of Say's Law and how it no longer applies to present economic phenomena.

Hansen writes that wages are equal to the marginal productivity of workers and that the marginal product falls as consequence of increased employment; hence, real wages decrease as employment rises. In addition, unemployment sets in when workers refuse to accept wages equal to their marginal productivity.⁶ Once wage-rates surpass the marginal productivity, jobs must be relinquished in order to compensate for the negative differential in the profit margin the entrepreneur receives from the production output when accounted for cost. Therefore, Hansen states, “*demand determines employment, and employment determines the marginal product (i.e., the real wage), not the other way around.*”⁷ Hansen believed that real wages are not equal to the marginal disutility of labor

5. Hansen, *A Guide to Keynes*, pg. 20

6. The inability of wages to be reduced is only applicable to an economy that has been regulated by government so that the entrepreneur must pay the laborer a certain wages and can not offer lower wages. This is often associated with labor unions. It must be noted that the free market need not worry about such things as the inability of wages to shift in a downwards direction. There could be contractual agreements between laborers and entrepreneurs in the market economy that do not allow the entrepreneur to shift wages downward but such would be unfavorable to the latter and would merely account for increased costs of production.

7. This is a peculiar statement by Hansen, as Hazlitt will later point out, because the Keynesians speak of the labor force as if the number of individual workers were given by the amount of individuals seeking jobs. In this sentence, Hansen seems to understand or at least acknowledge the existence of demand and supply schedules for employment that determine the quantity of workers employed. Again, Hazlitt will show later that it is the entrepreneur that determines that number of individuals employed, not *vice-versa*.

and that labor is willing to accept monetary wages lower than current real wages. Hansen argues that increases in labor brought about an inflation of money prices due to a rise in demand caused by further additions to aggregate incomes. Keynes, as Hansen points out, suggests that only by increasing demand will price inflation occur when employment is increased. Keynes also believed that a cut in money prices was not necessary to induce a fall in real wages but by increasing demand, employment will rise and real wages will decline. Therefore, economic actors are willing to accept higher money wages even though it will cause a rise in prices and, therefore, a decrease in real wage-rates.⁸ That said, this only holds true if the given industries operate under increasing marginal cost. Hansen concludes by stating that only the market can determine money wages but that real wages are established by money wages accounted for changes in inflation. Hence, real wages are always determined by the monetary authority or the flow of the market; that individuals do not account for real wages in their labor contracts.

B) Henry Hazlitt's View

Hazlitt starts off by expressing the validity of the first postulate that “*the wage is equal to the marginal product of labor*” but attributes this conclusion to marginalist revolution doctrine. Keynes credits this theory to “orthodox-classical” theory but such a claim is fallacious for the only known proponents of such an economic law are those that take after the marginalists.⁹ The second postulate states that “*the utility of the wage, when a given volume of labor is employed, is equal to the marginal disutility of that amount of employment.*” Hazlitt attacked Keynes' explanation of this postulate by addressing his *lack of clarity* and that the use of the word “disutility” was far too broad. Hazlitt was unaware of any “orthodox-classical” law that one could derive this fundamental from and simply dismissed it as an irrelevant reference by Keynes. Instead, Hazlitt defines the marginal theory of wages and employment by stating that wage-rates are equal to the marginal productivity of labor when employment is “full”; that is, when all able-bodied individuals seeking work are hired. Unemployment exists, according to the marginal theory of wages and employment, when wage-rates surpass the marginal productivity of the workers. In such a scenario, the business is incurring a loss for maintaining workers whose performance is not superior, or equal, to the wage-rate give unto them.

8. This is quite similar to the affect of labor unions on the economy. Due to an increase in wage-rates of some individuals in a given industry, the workers that would have been hired to that production process now move into alternate sectors of the economy. This shift in workers into the alternate industry causes an increase in the supply of labor in that industry, decreasing overall wage-rates. Therefore, in one instance you have labor unions increasing wages in one sector but at the expense of other individuals. Please see Watts, *Union Monopoly*, pg. 35

9. The marginalists that Hazlitt specifically credits this theory to are those who followed the teachings of Jevons, Menger, and others that were more in-line with Austrian school of economics doctrine.

This scenario might occur for the following reasons:

- 1) Unions raising wage-rates beyond such a point that it surpasses the marginal productivity of workers.
- 2) Growing inefficiency of labor.
- 3) Drop in the demand for the select output.
- 4) Decrease in the price of the output.

Keynes goes on to specify in the *General Theory* that these postulates were fundamental to the classical theory of labor and were the determinants of the volume of employment at any given time. He goes on to state that the first and second postulates determine the supply and demand schedules, respectively. In addition, the intersection between the utility of the marginal product and the marginal disutility of employment signifies the amount of individuals employed. Hazlitt counters these statements by arguing that the first postulate does not simply give the demand schedule for labor but reveals the actual point of intersection of both the supply and demand schedules. The demand schedule is given by the wage-rates employers are willing to offer and the supply schedule is given by the number of individuals willing to work at that given wage-rate.

Hazlitt then tackles the assumption that individuals are more interested in money-wages than real wages. Hazlitt reveals that the number of economists, executives and other individuals interested in knowing about changes in CPI¹⁰ are growing. In addition, there are many outstanding contracts in which laborers clearly state a desire to have their wages increased as the cost of living rises. One can not assume that individuals are naive and would not understand the element of inflation, inflation is a very real factor in the modern economy. In order to maintain a certain standard of living, individuals have resorted to demand wage increases accordingly to positive changes in CPI. Even so, the classical theory never argues against the acceptance of money-wages over real-wages but that once wage-rates surpass marginal productivity, unemployment will exist.

Keynes then states that when monetary wages fall, real wages rise and if monetary wages rise, real wages fall. This is an incorrect attribute for there have been epochs in recent history, specifically 1939-1957, when money-wages rose and real-wages also increased. Though this is correct, it has been

10. CPI stands for the *Consumer Price Index* which is an index of prices that notify the readers of changes in prices in certain industries and give a rough estimate as to the standard of living a family may have with a given amount of income. The CPI is often used as a measure of inflation and can be vital in understanding the affect inflation may have on the standard of living of individuals that obtain a certain wage-rate.

statistically shown that usually when money-wages are falling, real wages are increasing yet this is no novel idea of Keynes.¹¹ This observation by Keynes in the *General Theory* is nothing to herald due to the fact that it has been expounded by various other economists before his day. Next Hazlitt counters that idea that bargaining between businessmen and workers determine real wages. Hazlitt states that this an oversimplification of the reality of wage bargaining. That various transactions occur between workers and entrepreneurs to decide such matters.

Hazlitt goes on to state that using the term “the general level of wages” with “the general level of prices” suggest that the two fall and rise conjointly. This is incorrect for this is the reason why inflation and deflation occur, because these two elements fail to maintain uniformity. Wages and prices rise and fall in relation to each other but there is no direct correlation between the two in either a negative or positive direction. In addition, Keynes goes on to point out that changes in the purchasing power of money affect all individuals equally. This is incorrect because as money is printed by the monetary authority, those bills are masked at its *current purchasing power* versus its *real purchasing power*. As the new money is used, it trickles through the economy altering the value of those bills and setting it close to its real purchasing power.¹² The primary flaw in Keynes' analysis of the general level of wages and prices is that he neglects the vast differences in wage-rates relative to specific industries and the impact an alteration of the purchasing power of money can have on a single industry.¹³ Hence, there is little connection between variations in wage-rates and prices.

Wage-rates are not set by labor but by the various elements (*i.e.*, supply and demand schedules for labor) in the market economy and, in part, due to labor unions. Fundamentally, the market sets the wage-rates, not the labor force. In certain instances, labor unions have a significant role in setting

11. Hazlitt's purpose in addressing this scenario were both money-wages and real-wages were increased was to identify a flaw in Keynes' reasoning, that there is a specific direct relationship between the two. These relationships are scheduled to change and it is impossible to understand the exact path of human action. All economic relationships are alterable and it is unwise, unscholarly, to think otherwise.

12. Lets take an example of an individual who is magically given \$100 by a benevolent angel. This addition to the money supply has altered the real value of all outstanding dollars in circulation because there is a greater abundance of these bills. That said, the individual will go out and use those \$100 to purchase items equal to the current purchasing power of those \$100 and not at the true value. If at the current value (*e.g.*, purchasing power) the individual could buy two hats yet at its true value the individual may only be able to buy one hat. Such a small denomination of money may change the real value of money quite minimally but the monetary authority rarely simply prints up \$100 during an inflationary period. Monetary authorities print up billions of dollars over time and use this money at its “current” purchasing power versus its real purchasing power. Hence, those who control the supply of money have a direct advantage over those who do not for they manage the value of the currency and have the nation's purchasing power at their whim.

13. This point was not elaborated and must be. When the monetary authority issues credit at current purchasing power, and not at the dollar's real purchasing power, it allots some of the society's purchasing power to another individual. This individual may be the head of a specific industry, and often times this is the case. Thus, purchasing power of the dollar is moved from all members in society to one specific groups of individuals that may or may not be in a specific industry. Therefore, is one industry has greater purchasing power than another, inflation does not distribute evenly across the board.

wage-rates but this is often at the expense of a rise in unemployment and a subsequent decrease in the wage-rates of workers in other industries. It is also important to note that resistances in the reduction of money-wages is not met by a free market but by labor unions. These labor unions artificially create unemployment by raising the relative wage-rates of the given industry. By doing so, a number of workers must be laid-off in an effort, by the entrepreneur, to set the marginal productivity equal to the prevailing wage-rate.

Hazlitt goes on to discuss Keynes' analysis of Say's Law and the many fallacies included in this section. Keynes is primarily known by his followers as the great economist who finally disproved Say's Law. Jean-Baptiste Say¹⁴ was an 18th century political economist who sought to prove that the reason why there were minor downturns in the economy were not attributed to an overproduction in the market economy. Jean-Baptiste Say indicated that supply creates its own demand and that a supply of one factor can be identified as a demand for other factors. The idea that supply creates its own demand is fundamental in the belief that an equilibrium exists in all production in an economy. In addition, Say argues there exists a proper¹⁵ balance between price and cost, wage and prices. Hence, overproduction in one sector signifies an underproduction in another. Say's Law also assumes a fluid market, unhampered by state intervention.¹⁶ Say's Law proclaims that macro-overproduction can not occur but what can not be assumed is that he speaks in the specific. If wage-rates are kept still or rising, due to unions, those who adhere to Say's Law would believe that unemployment would arise in response to this artificial increase in the monetary wage-rate. Unions, in this respect, would have to be protected by government intervention and not simply a collaboration between laborers to protest a particular wage-rate at their own risk.

Hazlitt then argues that the purchasing power of the monetary unit in a market economy is a directly correlated with the production of wealth; that the purchasing power does not affect production but that production affects the purchasing power. Hence, any alterations in the purchasing power of the monetary unit can be, in part, attributed to changes in the output of the overall economy.¹⁷ It is

14. The author suggests Say's *A Treatise On Political Economy* in order to have clear perception concerning Say's belief on market equilibrium.

15. "Proper" is used to signify an equilibrium and not a "just" level. This is speaking in terms of economic analysis and is apart from any ethical arguments in favor of a certain price or wage level.

16. One of the factors that Keynes' does not list in his disagreements with Say's Law is that it assumes an unhampered market. Surely, a market with price floors, price ceilings, rent controls, minimum wage, a central bank, and government debts do not account for "an unhampered market" but simply aid the inability of Say's Law be carried out.

17. It is important to note that this is the case only when genuine savings is equal to investment. Once this direct relationship is altered, the purchasing power of the monetary unit will also differ. This often occurs in the modern economy due to the inflationary tendencies of the monetary authority. The central bank, *vis-a-vis* open market operations, is constantly altering the relationship between genuine savings and investment leading to alterations in the purchasing power of the monetary unit. Hence, as the central banks increase the issuance of fiduciary media, the purchasing power of standard

important to note that the countries that produce heavily, also consume heavily. That due to production, the purchasing power of the medium of exchange will change relatively.¹⁸

money begins to decline. Likewise, as the monetary authority decreases the money supply, the purchasing power of standard money increases.

18. This is relationship between increased production of goods and an increase in the value of the monetary unit is more thoroughly on pg. 196 of Rothbard's *Man, Economy, and State*.

Section II:

Chapter 6 of *The General Theory*: The Definitions of Income, Saving, and Investment

A) Alvin H. Hansen's Position

Hansen claims that there are *three concepts* involved in understanding the true nature of income. First, is the amount of total expenditures on consumers goods and investment goods; the second can be derived by analyzing the value of the many factors of production; the third method of understanding income is by taking aggregate sales and subtracting from it, the costs of production. These three methodologies are quite fundamental to the Keynesian model in revealing the connections between income and economic fluctuations. By analyzing these factors, one could understand the impact that a change in national income¹⁹ may have on the stability of the overall economy.

Hansen explains that in the Keynesian model there is an element of “involuntary losses” that contribute greatly to determination of the level of national income. When addressing involuntary losses there are two subcategories, these are:

- 1) Involuntary, but *not unexpected*, losses
- 2) Involuntary, but *unexpected*, losses

Involuntary but not unexpected losses are defined by Keynes as “supplementary costs” that are taken into account by entrepreneurs and corporate bodies. Supplementary costs are mildly important because these uncertainties would already be accounted for when calculating the national income. Involuntary but unexpected losses are labeled as “windfall” losses. Examples of windfall losses include unforeseen military attacks during wartime or a sudden turn of bad weather (*e.g.*, hurricanes). Keynes believed that one could arrive at the *net* national income by deducting all expected involuntary losses, over a given period of time, from the national income. Hansen's differs with Keynes in this regard by arguing that everything is foreseeable, that all entrepreneurs account for such uncertainty in some manner. Keynes also believes that the depreciation of capital goods can be calculated into the national income as “user cost.” Hansen disagrees and states that it is quite difficult to properly measure the user cost of the depreciation of capital goods in the national income. Hansen holds that it is quite tedious and somewhat unnecessary to account for all the economic phenomena that make up the national income. Hence, the goal of the national income is to arrive at an overall numerical denomination that

¹⁹. National income can be derived in various ways and is a significant tool in Keynesian economics when trying to analyze the amount wealth accumulation in a given region.

has accounted for a significant percentage of the elements that comprise the figure.

Keynes, Hansen describes, labels income as investment plus consumption expenditures and saving as income minus consumption expenditures; therefore, savings is equal to investment. That said, though savings and investment are necessarily equal, they are not always at equilibrium. Hansen claims that if there are no lags in the adjustment of the economic functional relationships, savings and investment would be equal at any given point in time. Yet, lags are common in the market economy and are the primary cause of a differential between investment and savings or a need thereof. Hence, due to the fact that lags *do* exist, savings and investment do not necessarily equal at any given moment.²⁰ Hansen states,

If, for example, there is an expenditure lag (i.e., if consumers adjust their expenditures slowly to changes in income), then, until the lag has worked itself out, actual consumption will not be equal to desired consumption (and actual saving will not be equal to desired saving).²¹

Hansen goes on to suggest that if there was a lag in producer output, entrepreneurs would have to slowly cope with differentials in sales that would lead to unintended investment in inventory stocks. In other words, real investment will differ from intended investment. Without these lags investment and genuine savings would be equal at any given moment. Yet, as lags persist in the market economy there will be a gap between intended and actual investment; hence, savings and investment will not be at equilibrium. Therefore, it might be the role of the government to intervene in the economy and stabilize the market so as to not bring about another episode of the business cycle.

B) Henry Hazlitt's View

One major problem Hazlitt encounters during the analysis of the *General Theory* is the misuse of terms “actual” and “expected.”²² Keynes, throughout the *General Theory*, mixes these two distinct terms together creating an unclear understanding of the Keynesian doctrine. Hazlitt then writes that

20. This understanding that there is a negative effect due to a positive change in the ratio of savings to consumption can be found in mercantilist texts of the 17th and 18th centuries. Benjamin Franklin speaks of the negative effects on the economy savings have in his forgotten essay “*A Modest Enquiry Into The Nature and Necessity of Paper-Currency.*”

21. Hansen, *A Guide to Keynes*, pg. 59

22. In the case of “actual” versus “expected,” Keynes rarely notifies the reader that he is speaking of future yields and occurrences or current yields and occurrences. This is quite important when understanding economic phenomena because there is a real difference between what has happened and what entrepreneurs estimate will come about.

Keynes, in *A Treatise On Money*, refers to the act of saving in terms of monetary units and not in all forms of capital; that throughout *A Treatise On Money*, Keynes tries to illustrate the differences between the phenomena of saving and investment. In the *General Theory*, Keynes implies that savings are inexplicably equal to investment in all forms of capital. Much of Hazlitt's concerns with Keynes relating saving and income is that he fails to label the terminology with respect to *monetary* or *real* income; rarely does he clarify if he is describing real or monetary income. *A Treatise On Money* clearly states that savings are only a monetary phenomena but that investments are in terms of specific goods; that said, he later labels a portion of capital as liquid investment. What is money other than liquid capital? The ambiguous use of the terms income, saving and investment in the *General Theory* one of the most recurring problems present in this chapter.

Keynes labeled savings as detrimental to the economy and was due, in part, to cultural boundaries; that if the populace were inclined to save less, production may finally increase to its optimum level. What must be stressed is that saving, by its very nature, allows for increased production and a growth in capital. Saving allows individuals to repair or increase the amount of capital in the production process in an effort to yield increased output at a later date. When there is an increase in saving, more money is put aside to be used towards capital production and investment purposes. Therefore, by saving individuals allow for greater *future* consumption at the expense of current consumption, allowing for a rise in economic growth. Hazlitt directly attacks Hansen's argument concerning the lag aspect of saving and investment by stating that his position is self-contradictory. It must be noted that if a change does occur in investment or saving, both must still be equal to each other. This “lag” is not an arbitrary state of saving or investment but a very real moment in time where there is a true relationship between the two. If one is to claim that saving and investment are *always* equal then it must also follow that at whatever state one of these factors are in, the other factor will also be in that same state.²³ The “lag” factor is not sufficient evidence to pardon Keynes from his lack of clarity on the subject.

It must also be noted that throughout the *General Theory*, Keynes scorns the act of saving as unproductive yet writes of investment as a beneficial element to the state of the economy. If savings and investment are in fact equal equal, as is stated many times throughout this chapter of the *General Theory*, then how is it possible that Keynes justify one while discouraging the other? The answer is found in Keynes' confusion on the matter and his inability to properly clarify his definitions. Keynes,

23. This is specifically addressing an negative or positive changes in either investment or saving. That if saving is to positively increase, so will investment. Hence, savings and investment are always in a direct relationship with one another and can not be separated into two different phenomena.

with a lack of clarity and logical argumentation, deplores saving as *reducing* income and investment as *increasing* it. It is logically flawed to state that saving is a negative economic occurrence because it cuts back on consumption of goods but that investment is a necessity to production for it allows the purchasing of capital goods. Hence, there can be *no* investment *without* saving. In order to invest an individual must first refrain from the purchasing of consumer goods. Only by individuals cutting back on their rate of consumption will increased *stable*²⁴ investment be beneficial in spurring economic growth. As Hazlitt writes,

*“a man's tastes change and he switches from chicken to lamb. We don't scold him at one moment for hurting the poultry raisers and praise him the next for aiding the sheep raisers. We recognize that his purchasing power has gone in one direction rather than another, and that if he had not given up on the chicken he would not have had the money to buy the lamb.”*²⁵

24. There is quite a difference between stable and unstable investment. When there is a positive differential between genuine savings and investment, there will be unstable investments that have been artificially encouraged by the monetary authority through open market operations. This phenomenon will be evaluated further in subsequent sections.

25. Hazlitt, *Failure of the “New Economics,”* pg. 91

Section III:

Chapter 8 & 9 of *The General Theory*: The Propensity to Consume

A) Alvin H. Hansen's Position

Hansen disregards the use of *ex post* equations in economic analysis and proclaims the need of current explanations of economic functional relationships. Keynesian analysis takes into account all expectations and functional relationships available in order to accurately describe economic phenomena. Hansen declares that the existence of these functions can be proven or disproven by simply analyzing patterns in economic behavior. This use of empirical data as a determinant of economic fundamental law is quite prominent in current “new economic” theory.

Hansen argues that the volume of employment in a given region is realized by determining the intersection of its respective aggregate supply and aggregate demand curves. Aggregate demand can be deduced by summing up all consumption and investment expenditures. When concerning the makeup of the aggregate demand function, Hansen makes two distinctions. One portion of the aggregate demand function is determined by the consumption function and the other is realized by analyzing the investment-demand function. The consumption function is able to determine the rates of consumption and employment present in the economy. Hansen goes on to state that real income and employment are *directly correlated* in the short-run but that in the long-run real income will rise *proportionally* to employment. Hence, by increasing consumption, employment is increased and thus, in the long-run, real income will also rise. Hansen then claims that the consumption function allows economists to visualize the relationship between real income and employment in the long and short-term. By using the consumption function, Keynes was able to verify his hypothesis that consumption can only exist with the consumption of real income. Hence, price is the principal element that decides the quantity of labor transacted on the market and is therefore determined by the intersection of aggregate supply and aggregate demand.

The purpose of the consumption function, and its supposedly accomplished task, is to determine the level of consumption with a given change in income; that said, Hansen does not specify whether consumption correlates with *real* or *monetary* income. The consumption function is set by both *objective* and *subjective* factors. The objective factors are all proven functional relationships between economic phenomena. Subjective factors are psychological and social determinants of the overall state of the economy. These subjective factors change the proportionality of the objective relationships. Such subjective factors may include changes in taste or cultural preferences; these alterations would not be immediate nor radical but instead are usually implemented over given

timespan. These factors that contribute to the proportionality of consumption with income and consumption with employment may fall as individuals reduce the percentage of income spent on consumption goods. For instance, a rise in the desired wants of a more luxurious future would increase the propensity to save and therefore, having a significant impact on employment and long-term real income. Keynes then indicates that “*as a rule and on the average*” as income increases, so does consumption but there is still a portion of the income saved by the individuals. Thus, if Keynes is to claim that as income rises so does consumption and that ΔI (*e.g.*, change in income) contributes ΔC (*e.g.*, change in consumption), then there is a change in ΔS (*e.g.*, change in saving).²⁶ As ΔI increases so does ΔC but ΔS also rises over that given timespan. The end result of Hansen's analysis of chapters 8 and 9 is that employment can only increase with an increase in investment and consumption and that as ΔS becomes greater, aggregate demand will not intersect with aggregate supply at the proper point. This will create a detrimental gap between the investment, consumption, and employment that would consequently have to be eliminated by spurred investment sponsored, in part, by monetary and fiscal policy.

B) Henry Hazlitt's View

Hazlitt believed that economic phenomena could be understood through logically deducing certain fundamental laws and not by analyzing mathematical formulas. Mathematical formulas may serve to prove or aid the economist in the analysis of the market but economic laws can not be based on mathematical formulas alone. Throughout this chapter, Keynes employs the use of mathematical equations and data as an adequate method of understanding trends in the economy. Aggregate supply, Keynes labeled, is a functional relationship between supply prices and number of men employed; likewise, aggregate demand was a functional relationship between number of men employed and expectations. Hazlitt argues that these mathematical formulas are not valuable to economic analysis because the *premises of the variables in the equation* are often ill-founded and ambiguous. In order for mathematical equations to serve any analytical use, the premises (*e.g.*, the variables) must be established before the structuring of the formula. Mathematical economics can be used by entrepreneurs to reduce their risk and *predict* fluctuations in future demand or supply. On the other hand, these entrepreneurs can not *know* future demand nor can economists obtain such information. Graphs and mathematical formula are designed to aid individuals and are *not* designed determine the

26. In the General Theory, Keynes states that over a given period of time savings will increase but he never states if he is speaking in numerical or real terms. This will be discussed in further sections but the fear Keynes has of increased saving without a change in the proportionality between savings and consumption is irrational.

underlying premises of the equations. The use of demand curves are simply for visual aid in understanding marginal utility and the demand for items. One can never, by using the most accurate aggregate demand curves, truly determine exact price due to a specific movement along the demand curve. Economists can only know, for example, that if supply is unchanged and demand shifts to the right that prices will rise but by what degree those prices will increase can not be perceived, only predicted.

In addition any shifts and changes in the slope of the Keynesian consumption function *can only be estimated*; these shifts may or may not occur. Time plays a significant role in the identifying the fallacy that the slope or position of the consumption function, even if the relationships in the function are valid, can be properly understood and calculated. These shifts may take a certain unknown period of time and, in fact, may not occur at all. Government monetary and fiscal policy *should not* rely on false premises but must be altered to serve the irrefutable fundamentally laws of economic science. Hazlitt states that Keynes, in discussing aggregate demand, makes an invalid claim concerning how entrepreneurs decide what their net proceeds will be. Keynes argues that entrepreneurs calculate their desired net profit with the predetermined information that they will be hiring a certain amount of employees; that businessmen first hire employees and then calculate what profit margin they will receive. In reality the entrepreneurs calculate net profit by determining the number of products that need to be sold in order to receive a certain net yield. This fallacy is one of the most important misconceptions in Keynesian economics when concerning the behaviors of individual actors in the economy. The entrepreneurs decide how many employees they need to hire in order to receive a certain profit margin, not how much profit will be left after employing a set number of workers. This is crucial because entrepreneurs are not concerned with hiring a given amount of factors for their production processes but how many factors will be needed in order to receive a desired net profit. Hazlitt argues that the distinctions made in the *General Theory* between the terms “consumption,” “investment,” and “saving” are quite inaccurate because of instances where an individual may buy a good that they may use for both capital and consumption purposes. Hazlitt elaborates,

“If you buy a power mower strictly to use on your law, it is doubtless part of your 'propensity to consume.' If you buy it to rent out to others, it is an 'investment.' But what is it if you use it partly for your own law and partly to rent to others? Such questions are enough to show that the line between 'consumption' and 'capital goods,' between 'consumption' and

*'investment,' is not as clear and sharp as Keynes' elaborate theoretical division implies.'*²⁷

Hazlitt is correct in this regard, when implementing mathematical functional relationships, one can not dismiss these obvious problems. Such observations show the lack of grounding the Keynesian doctrine has in the identification of the nature and role of capital and consumption goods. In addition, it sheds light on the fallacies of Keynesian partitioning and the belief that economic factors are separate elements. Hazlitt goes on to claim that the consumption function is ambiguous and inaccurate. Keynes says that as income increases, so does consumption and with it, so do savings. Keynes later argues that government can step in and eliminate this perpetual saving trend and redirect it towards more valuable²⁸ investments. In all actuality, an increase in savings by economic actors is quite beneficial to the markets and allows for economic growth *vis-a-vis* a shift of resources from consumption goods processes to capital production. It is also incorrect that by an increase in saving, in the long-run, tends to create unemployment and poverty. The Keynesian school's main villain throughout their doctrine, is the propensity to save and the supposed unemployment and bust phases that occur due to individuals not fully consuming their income.

27. Hazlitt, *Failure of the "New Economics,"* pg. 108

28. This is another fallacy present in Keynesian economics, that the government can perceive differences in value. When government spurs investment, it has little understanding that, by creating a positive differential between saving and investment, a certain portion of the artificially motivated economic growth is unsustainable precisely because of the existence of this differential.

Section IV:**Chapter 15 of *The General Theory*: The Psychological and Business Incentives to Liquidity Preference****A) Alvin H. Hansen's Position**

Hansen begins his discussion of liquidity preference by first identifying the historical purposes of money. Over time, economies move toward a more highly marketable good in order to expand the amount of trades completed and allow for a greater the division of labor. In order for a commodity to be maintained as a medium of exchange, it must be a proper storage of value. In other words, if media of exchange do not properly hold their value then they fail as a storage of value and will not be chosen by the market as it's medium of exchange. When an individual sells their labor for a medium of exchange, that laborer wants to secure the purchasing power of their labor and not have the value of the commodity deteriorate over time. Trading services for a commodity that acts poorly as a storage of value, that the value of the commodity is eroded over a period of time, eliminates a percentage of the initial value of that individual's labor. Hence, the reason a certain commodity becomes a medium of exchange is because it has certain characteristics that allow it to serve this function, one of these characteristics being store of value, and if such a commodity does not hold these characteristics then it will not be selected as a medium for exchange by the market. Hansen goes on to state that people store and hoard money due to uncertainty about the future. Keynes believes that this uncertainty of the future and the hoarding of standard money was neglected for some period of time and that it was vitally important in understanding the rate of interest and how the “demand to hold” function of money plays a significant role in the supposed lack of investment.

Keynes views the interest rate as an incentive for individuals holding liquid capital to move their purchasing power into loanable funds markets or riskier investments. Hence, the opportunity cost of holding money as a liquid asset is the interest forgone on that amount of capital. Hansen states the there are various reasons why individuals hoard cash. These reasons are of transaction motives, precautionary holdings, and speculative purposes. Transaction motives stem from the need of individuals to use a given amount of hoarded money for immediate use. In other words, the one of the reasons people hold cash is because at some moment they may decide they are going to need the money for immediate transactions. For instance, an individual may have one-hundred dollars in their wallet that they are planning on using in the near future to complete a certain transaction. Precautionary holdings can be identified as hoarding by individuals who foresee a future occurrence in which they will need cash in order to sustain their livelihood. For instance, foreseeable natural disasters

play a large role in individuals hoarding their money for precautionary motives. However, Hansen states that the primary cause of hoarding is due speculative nature of money. Individuals may foresee a downturn in the economy in which case holding liquid assets would be optimal in order for the individual to have increased security in their purchasing power.

The rate of interest is a main deterrent factor in holding money for speculative motives and can be used to drive the amount of outstanding liquid assets hoarded downward. This is seldom true when concerning the transaction and precautionary motives of cash hoarding due to the fact that individuals see this form of asset holdings as necessary in maintaining an efficient and comfortable life in disastrous times. Therefore, the interest rate can be manipulated so as to relieve hoards in times of disparity and encourage investment during expansion phases. High interest rates have the affect of the encouraging individuals to move their hoards into loanable funds markets or riskier investment and low interest rates allow for a greater amount of investment.²⁹ Hansen used this “interest-elastic” property of the propensity to hoard as another factor to counter the “orthodox-classical” acceptance of Say's Law. According to Keynes, when understanding Say's Law in relation to hoarding, only two conclusions can be established: “1) *Say's Law holds regardless of the money supply and 2) It holds only under conditions of monetary equilibrium.*”³⁰ Hansen argues that the first proposition would hold true regardless of the monetary policy that was in effect; the second would only be valid with an elastic monetary policy. Keynes argued that both positions were flawed and used his discussion concerning liquidity preference as another method of defeating Say's Law.

Hansen states that because of the ability for open market operations to be conducted and that the interest paid on bonds by banks are bid to a certain level, that the speculative motive function of hoarding is a curve that shows a relationship between the rate of interest and the quantity of money; that as the quantity of money is increased, rate of interest falls. Thus, what Keynes is trying to express is the supposedly undeniable truth that “*uncertainty as to the future course of the rate of interest is the 'sole intelligible explanation' of the speculative motive for liquidity which leads to golding inactive balances.*”³¹ Hansen argues that as the difference between the *current rate of interest* and what individuals see as the *probable future rate of interest* increases, so will the amount of cash be held in hoards for speculative motives. That said, Hansen states that the “absolute level” of interest is

29. The question that will be answered in subsequent sections is if this type of investment is *sustainable*. An artificial fall in the rate of interest does have the affect of spurring investment. The quantity of investment is not what is important so much as the *quality* of investment. There is a significant difference between *sustainable* and *unsustainable* investment that will be addressed shortly.

30. Hansen, *A Guide to Keynes*, pg. 130

31. *Ibid.*, pg. 131

somewhat controlled by the elasticity of the speculative demand for cash. Therefore, as the rate of interest begins to decline, the speculative function becomes more interest-elastic” due to an increase in the number of individuals hoarding liquid assets. Because of the underlying factors of the speculative function, an increase in the supply of money should have the affect of lowering the rate if interest. Hansen elaborates by stating that “*the price of bonds can be raised sufficiently (via open market operations) to induce some 'bull' to sell his bond for cash and join the 'bear' brigade.*”

Hansen believes that as new money is introduced into the economy, it will have the affect of increasing the incomes of those individuals that received the funds and subsequently will increase consumption, lowering the rate of interest. Therefore, there are three methods of storing wealth:

- 1) Loans
- 2) Capital/Equity
- 3) Cash

An increase in the hoarding of cash as a storage of wealth has the effect of increasing the rate of interest. Hansen believes that a *runaway bull market* can be cooled off by an increase in the rate of interest and by lowering the rate of interest a *bull market can be spurred*. At the height of a boom, the propensity to hoard will tend to increase as individuals begin to fear a liquidity crisis and the failure of their investment assets. As the beginning of the expansion cycle sets in, the propensity to hoard begins to decline as individuals see a greater incentive to invest due to the high rate of interest. Hansen argues that the rising interest rate during the crisis phase of the business cycle has the effect of creating a more damaging recession.

The inducement to invest, by lowering cash hoards during periods of economic expansion, has the effect of speeding up the expansion of the economy. During this segment of the expansion phase, Hansen states that rate of interest tends to rise and begins to slow down the expansion by lowering investment. Therefore, during a period of expansion cash hoards are moved into equities and bonds; during periods of crisis, equities and bonds are liquidated for cash or moved into more liquid assets. In the expansion phases, there is a movement from bonds to equities (bull market) and in a contractionary phase there is a movement from equities to bonds (bear market). As the expansion phase continues, the individual uncertainty begins to rise and will multiply until a large percentage of investors liquidate their investments and move equities in cash. This growing belief that the expansion phase is coming to an end increases the propensity to hoard by individuals as they fear liquidity crisis. Thus, the true cause

of hoarding is uncertainty and this uncertainty is further brought about by increase in the rate of interest; that by manipulating the rate of interest, the natural capitalist boom and bust cycles could be somewhat stabilized.

B) Henry Hazlitt's View

Hazlitt states that in order to have loanable funds, individuals need to save; that for investment capital to exist individuals must refrain from current consumption. It is important to understand that the reason the rate of interest is a real factor when calculating investment is because individuals do not use the entirety of their income on consumption. Hazlitt disagrees with the Keynesian idea that the interest rate is the reward given to the lender by the borrower to refrain from hoarding. He states that the interest rate, or the differential between the final amount versus the initial amount, is the *compensation* an individual lender is given by the borrower to forgo current purchasing power in exchange for future purchasing power. Time preference theory tells us that individuals prefer equal goods sooner rather than later, the only differences in the gravity in the want of the good. This is why there are two denominations of time-preference in economy theory, one is *low time-preference* and the other is *high time-preference*. High time-preference denotes an individual that is more willing to hold on to current goods rather than exchange them for future goods. *Vice-versa* can be attributed with individuals who have low time-preference. Thus, it can be deduced that in order for an individual with high time-preference to part with their current purchasing power, the prospective borrower will need to pay a higher interest rate in comparison to borrowing from a lender with low time-preference. In addition, the interest rate the lender offers to the borrower reflects the potential uses or investment opportunities that individual is foregoing in order to lend the funds out. Hence, the interest the individual demands from the borrower in order to part from their current liquidity is determined by the lender's level of time-preference and the foregoing of prospective returns in any alternative uses; these prospective yields not only include monetary returns but psychic returns as well. For instance, an individual may not lend out their current liquidity because they value any current consumption, using those liquid assets, higher than lending them out at any rate of interest.³²

Hazlitt then states that if it is true that the rate of interest is the “reward” for parting with current liquidity could it not also be determined that the price offered by sellers must be of sufficient degree to overcome the current liquidity preference of the buyer? It seems only fitting to compare the two under

32. Such a case is probably nonexistent but it nonetheless has the possibility of occurring. Children may be a great example of individuals who may never want to lend out a certain amount of cash they have acquired, regardless of the return, because they expect they are going to use those funds in order to purchase a good they currently desire.

such rationale. Hazlitt regards the Keynesian definition of liquidity preference and the subsequent connection to the rate of interest as a restatement of the obvious. Hazlitt scrutinizes the negative connotation Keynes, as well as Hansen, gives the “speculative motive” of hoarding and the subsequent call for government intervention to “fix” the problem. Keynes speaks of the monetary authority as the cure of economic ills and quickly jumps from identifying the “speculative motive” of hoarding to the need for a monetary authority to relieve the problem. Keynes identifies the speculative motive with the desire to not succumb financially to any alterations in the state of prices. Hazlitt points out that this is falsely regarded as speculation; that individuals hold cash as a preventative measure so that they would not have to speculate. It is the individual that wants to secure his other personal buying power who is more willing, during a time of crisis, to liquidate his assets and store wealth in the form of standard money. Individuals can not be motivated to ride the ups and downs of the market; each individual is trying to maximize their utility and have no desire to keep investments that are beyond acceptable risk.

Hazlitt indicates that these uses of the term speculation can be wide and varying. One can not claim that speculation in one factor is speculation in all factors. Hazlitt states that

“they are speaking, in short, not to speculate in investments or goods. They believe that next week, next money, or next year they will get them cheaper. This may be called speculating in money, as Keynes calls it or it may be called a refusal to speculate in stocks, bonds, houses, or automobiles. The real question to be asked about it, however, is not whether or not this is 'speculation,' but whether it is wise or unwise speculation.”³³

In order to eliminate business cycles, government must adopt a “hands off” attitude towards the nation's media of exchange. It is the monetary authority themselves that create the boom and bust cycles the modern economy is so familiar with by constantly manipulating the money supply in order to suit the interests of the government. Keynes states that the current functions of money include:

- 1) Store of value
- 2) Media of exchange
- 3) Unit of accounting

33. Hazlitt, *Failure of the “New Economics,”* pg. 190

4) Standard of value

The Keynesian's see this “storage of value” function of money as detrimental to economic order. Keynes goes as far as to relate individuals that use money as a storage of value as lunatics. Hazlitt refutes this position by correctly correlating the primary function of money as a medium of exchange. The remaining functions, store of value, standard of value, and unit of account, are the attributes that make a given commodity a proper medium of exchange; these are the functions that determine whether a society will use a given commodity as a medium of exchange. One can not claim that the fundamental elements of money evolved at the same pace; it is precisely the opposite. Individuals began to witness given economic and physical qualities in certain goods that allowed them the ability to be used as media of exchange. Therefore, it is invalid to uphold a given commodity as a medium of exchange yet disregard it as a store of value; these functions are not mutually exclusive. It must be noted that individuals rather not trade their goods or services for a medium of exchange that actively loses its value over a given period of time. Individuals do not wish to lose the value of their work, such a claim would be illogical. It is only proper to view money as an asset that individuals desire to either grow in value or at the very least maintain its worth.

Hazlitt then goes on to refute the Keynesian model of the rate of interest during different phases of the business cycle. If the Keynesian model were true, then

“short-term interest rates would be highest precisely at the bottom of a depression because they would have to be especially high then to overcome the individual's reluctance to part with cash to “reward” him for 'parting with liquidity.' But it is precisely in a depression, when everything is dragging bottom, that short-term interest rates are lowest.”³⁴

These claims by the Keynesian school are theoretically incorrect yet Hazlitt goes a step further by gathering statistical data in favor of the Austrian theory of the business cycle. Hazlitt illustrates using a graph labeled “Appendix D” in *The Failure of the “New Economics”* that the rate of interest and industrial production empirically are *directly correlated*. That when the country is in a recession, *interest rates are low* and when the country is in an expansion, *interest rates rise*. This analysis by Hazlitt uncovers a detrimental element in Keynesian doctrine. Many Keynesians counter Hazlitt's

34. Ibid., pg. 192

argument by pointing out that many long-term bond rates are in the low interest figures during the height of an expansion. Hazlitt concurs but states that this phenomenon is not a consequence of “liquidity preference” but due to a lack of confidence in the safety and ability to pay back the interest on bonds; *vice versa*, the price of bonds increase in price due to a growing confidence in the investment and safety of principal. Another argument Keynesians use to prove the validity of the liquidity preference theory is that at the beginning of the bust phase, short-term interest rates will increase dramatically. Keynes argues that this has to do with liquidity preference and greater compensation for heightened risk. Hazlitt disagrees and states that it has more to do with a rise in the amount of borrowers in an effort to protect current investments and sell off present inventories.

One of the areas where the author must part ways with Hazlitt is in attacking the use of the term “liquidity” to mean cash. Hazlitt states that a time deposit holds both liquidity and interest yet he can not deny that such an investment may, nevertheless, fall through. Rather than use Hazlitt's term of “cash-preference” or Keynes term of “liquidity-preference,” the author suggests the use the term “risk-preference” to describe such behavior. To Hazlitt's credit, Keynes' term clarifies little and is quite ambiguous if not supplemented by outside information. Hazlitt goes on to illustrate a society where the propensity to consume is equal to income and liquidity preference is nil. No individual would invest new income, even to cover depreciation of old equipment.

“Nobody would hire labor for manufacturing or construction or mining. Employment (except of personal servants, barbers, entertainers, etc.) would disappear. People would still want to borrow money, not to hold or invest but to spend immediately. But there would be no lenders! Nobody would spend it at once on his own consumption. Under such conditions, instead of falling to zero, the offers of would-be borrowers would raise interest rates without limit. The time-preference theory would also predict a tendency, under such conditions, for interest rates to soar toward infinity.”³⁵

35. Ibid., pg.196

Section V:

Chapter 16 of *The General Theory*: Sundry Observations on the Nature of Capital

A) Alvin H. Hansen's Position

Hansen claims at the beginning of this chapter that Wicksell was the originator of the attack that investment came directly from saving; that in order to investment, individuals would have to save. Keynes did hold that some savings are used for investment but that not all savings go directly into investment. As real income increase, the amount saved also increases. This eliminates a certain proportion spent on consumption goods and investment goods. This fall in the amount spent on consumption and investment goods will bring about a decline in real income and a subsequent fall in saving. Savings that are not directly funneled into investment opportunities will end up hurting the state of the economy through lowered consumption and declining investment. Hansen goes on to make the distinction between investors and savers in the modern economy; that one is not necessarily the other. Hansen parts with Keynes is the latter's belief that the propensity to save will not affect the interest rate. Hansen disagrees on the grounds that the liquidity preference schedule is not constant at all times. The function changes with rises or declines in the rate of interest. In essence, the rate of interest can not be determined only by the liquidity preference schedule and the quantity of money. That in order to know what the interest rate is, an individual must first calculate the income level.

Keynes goes on to state that the only units of production that should be accounted for in economic analysis are labor, money, and time.. The “environment” that the laborers and entrepreneur work in consists of natural resources, recipes, and capital; these are not factors of production but are merely resources that the factors of production, labor and entrepreneurship³⁶, use in the production process. Hansen believes that capital obtains its value due to it's scarcity because of the difficulty and length in capital production; capital is one of the more limited of the environmental factors. Keynes states that the higher the interest rate, the more time, energy, and risk is involved in the creation of capital and that the maximum amount of capital that can exist is when the rate of interest reaches zero. By setting the rate of interest closer to zero, more capital is manufactured. Hence, there is greater cost involved in the roundabout process of capital creation. In addition, capital will only be produced if entrepreneurs seek an annual yield that is significantly above the production costs of capital. Hansen then claims that “*capital has to be kept scarce enough*” to have it's marginal efficiency at least equal to

36. In Austrian economic analysis, the entrepreneur is not a factor of production but the individual who bares the risk associate with the production process. All factors of production are accounted for before the output is created. None of the other factors, except entrepreneurs, receive a negative return. Because the entrepreneur may receive a negative return if resources are misallocated, this indicates that they are not factors of production. The primary role of the entrepreneur is to bare one-hundred percent of the risk in the production process.

the rate of interest. Hansen states that a society that has accumulated so much capital that its marginal efficiency is below the rate of interest could exist. Regions may also experience little economic growth with a plentiful supply of capital and prosperous economic growth with a minuscule amount of capital. Hence, there may be an “optimum” level of capital necessary to produce prolonged economic growth.

Hansen goes on to state that at the end of an expansion cycle the economy is saturated with capital, causing a decrease in investment and therefore, fall in employment. In such a situation, the government could institute “balancing factors”³⁷ in order to stimulate the growth of capital to the point where the marginal efficiency of capital reaches zero.³⁸ Once that is accomplished, full investment would be reached and all products would be divisible by labor. This then would be the labor theory of value, when products can be made divisible by labor.³⁹ Keynes predicts that it is improbable that the interest rate could be driven down to zero for there would be certain limitations, even to institutional factors. Hansen finds much of chapter sixteen confusing and somewhat impractical. He believed that Keynes' theory was well developed but that the practical use of this theory has changed much since his death. Hansen minimally elucidates on Keynes' theory of capital in this chapter but more or less devoted this chapter to his view concerning the nature of capital.

B) Henry Hazlitt's View

To begin with, Hazlitt disagrees with Keynes that saving is a harmful function in the market economy. Keynes argues that the act of consuming later is no more beneficial than consuming today and that the need to save for increased consumption in the future is not in any individual's best interest. Hazlitt points out that seldom do individuals, other than the short-term, hoard cash under normal economic conditions. Often times economic actors place their savings in investment opportunities and equities in order to gain a decent return on their purchasing power foregone. Even if an individual places their savings in a checking deposit, the bank usually loans out those funds out towards investment opportunities. Another Keynesian fallacy in this chapter is that over a given period of time, saving can increase while there is a fixed ratio between saving and consumption. Hazlitt explains that just because the numerical savings may increase over a given period of time, the ratio is still fixed and

37. Hansen does not go into depth as far as what factors the government could implement in order to alleviate this problem. One can only presume that an increase in the money supply *vis-a-vis* open market operations would be one viable option in order to spur both investment and consequently, capital production.

38. It must be noted that Hansen does not share Keynes' opinion that the zero rate of interest is ideal. Hansen believes that there must be some productive level of capital that optimizes economic growth that does not necessarily have to be zero.

39. This highlights the Keynesian fascination with socialist economic doctrine. In this chapter, Keynes strives to make sense out of the labor theory of value in order to give strength to his argument that government intervention is necessary in order to stabilize economic phenomena.

saving hasn't truly risen in relation to income. It is only when there is a change in the relationship between consumption and saving will there be a true relative increase in one of these factors. This belief that overtime, even with a fixed ratio, that saving increases in real terms is fallacious. Even if Keynes meant that it increase in monetary terms, it would have been simply restating the obvious. Hazlitt correctly identified the lapse in soundness of this Keynesian argument. In addition, as this increase in the savings ratio does occur, the massive potential for an increase in investment due to the saving is enormous. By individuals saving a greater proportion of their income it will undoubtedly spur increased investment, through loanable funds markets and equities, and would eliminate a portion of the unemployment present.

It is also incorrect to state that a decrease in consumption will decrease employment in the long-term. As demand for consumption goods fall, the price of the factors of production in consumers goods and the output fall as well. This creates a surplus of workers in the industry that now will flood into the capital markets, that now have higher wages due to increased demand for capital, and thus, the unemployment will be eliminated. When there is a decrease in either consumption goods processes or capital good processes, due to a change in saving, much of the resources that were being bid on by entrepreneurs in consumers goods industries are now being bought up by entrepreneurs in capital production. The workers that where in the consumers goods process now move into the capital goods sector attracted by the increased wage-rate prompted by a positive change in the ratio of savings to consumption. A relative increase in capital goods allows for a greater production of consumers goods at a future date; this is the process that enables economic growth. A spur in investment caused by a decrease in *present* consumption is what enables an increase in *future* consumption due to increased *capital* production. Therefore, it is fallacious to claim that unemployment will ensue due to a fall in the consumers goods sector prompted by an increase in the amount (*e.g.*, total savings) or ratio (*e.g.*, real savings) saved. Even if increased savings would do mean increased hoards, this will only occur when individual expectations of investors fall and attitudes concerning the market become bearish. Hazlitt argues against Keynes' invalid claim that yields must be physical. In reality, not all yields are physical but many simply be value yields; that yields from the use of certain goods could be valued in relation to the pleasures or services derived from the use of those factors. Hence, individuals store money because they believe that hoarding will yield a better outcome than having it stored in investment opportunities and has little to do with this ambiguous theory of liquidity preference. That through hoarding, if individuals are correct in their predictions, society is benefited by not wasting resources in production processes that would not have yielded an overall profit. Hazlitt elaborates on Keynes'

ambiguous position on saving,

“For Keynes (1) constantly writes as if the man who holds money holds nothing of “real” value; (2) never tells the reader whether in any particular case he is assuming a constant or a changing money supply; and (3) never tells the reader whether in any particular case he is assuming flexible or rigid prices and wage rates.”⁴⁰

Hazlitt goes on to give Keynes' argument some rational justification. If there is a sudden act of saving by a majority of individuals, in a society where the money supply is stable, then unemployment will ensue for a specific time period. Hazlitt writes that this would occur *“as a consequence, not of “saving,” but of attempted saving.”* Unemployment will exist for a given period of time until the saved amount is then shifted to investment opportunities and capital good production processes; yet such a scenario would not be long lived. Hazlitt adds that this is only plausible when prices or wage-rates are in flexible in a negative direction and that, in such a scenario, the blame should not be put on the act of saving but on the inflexibility of wage-rates. In addition, economic downturns are not caused by hoarding liquidity but that act of hoarding liquidity is a reaction by individuals due to a fall in the overall productivity of the market. Under a constant money supply, investment is equal to genuine savings but when the money supply is altered, there will exist a differential between the two. When credit is issued to certain individuals or loaned out, this creates an increase in investment without an equal increase in the ratio saved. Hazlitt states that when *savings exceed investment*, a deflationary period will ensue. If *investment exceeds genuine saving*, an inflationary period will be prompted. If *genuine savings and investment are equal*, then there is neither inflation nor deflation. Keynesian doctrine finds deflation to be a negative monetary occurrence and that a monetary authority must be set up in order to make sure that the money supply is not increasing in value so as to not discourage investment.

Hazlitt disagrees with the Keynesian belief that the closer the marginal efficiency of capital is to zero, the more beneficial capital is to the economy. Hazlitt attacks this notion by stating that if capital were so abundant, there would be little incentive to repair it due to their *non-existent exchange value*.⁴¹ In such a scenario, *consumer goods would be also have zero value*. Under such conditions

40. Hazlitt, *Failure of the “New Economics,”* pg. 224

41. One of the primary determinants of price and value is the scarcity of a good. If goods were not scarce, the value of them would be nil. Therefore, if capital were so abundant that the marginal efficiency of capital reached zero, this would signify

everything from capital goods to consumers goods are abundant; scarcity is virtually non-existent. Also because the marginal yield of capital would be near or at zero, the *incentive to borrow would fall to zero* as well as the rate of interest. Hazlitt sums the argument,

“Capital will continue to have a marginal yield above zero, in brief, as long as it continues to help in the production of consumers goods that have a price above zero. And if these consumers goods have a price above zero, it will be not only because they fill human wants, but because their supply is not unlimited and because they cost something to produce. And it is this cost of production (and not some wicked conspiracy of the capitalists) that keeps them scarce.”⁴²

The American entrepreneurial, capitalist system, writes Hazlitt, has succeeded in advancing technology, standard of living and reducing scarcity. It is quite illogical to believe, as Keynes did, that one can simply create such an abundance of capital so that its marginal yield falls to zero, creating a world of limitless goods. In a world where *all elements are scarce*, even air and water, this would never apply.

that this capital is valueless due to its lack of scarcity.

42. Ibid., pg. 233

Section VI:

Chapter 18 of *The General Theory*: The General Theory of Employment Restated

A) Alvin H. Hansen's Position

Hansen begins this analysis by stating that there are a number of given elements in Keynesian economic theory and that changes may occur to them yet gives little thought to how or these alterations would come about. The given Keynesian elements are “*quality and quantity of labor and capital equipment, existing technique, degree of competition, consumer tastes, and the social structure which determines the distribution of income.*” In addition, there are so-called independent and dependent variables in Keynesian theory. Independent variables fluctuate accordingly with social behaviors and make up a large part of Keynes' doctrine. Hansen goes on to state that these independent variables are determined by the market wage-rate units. These independent variables are:

- “1. *The consumption function.*
2. *The marginal efficiency of investment schedule.*
3. *The liquidity preference schedule.*
4. *The quantity of money fixed by the monetary authority.*”

The dependent variables, on the other hand, are fixed and do not change easily. These dependent variables are:

- “1. *The national income, and the volume of employment.*
2. *The rate of interest.*”⁴³

Hansen part ways with Keynes concerning the fundamental independence of the rate of interest. Hansen argues that the rate of interest should be listed as a dependent variable while Keynes believed that because the determinants of the rate of interest are independent, the rate of interest must therefore also be independent. Hansen claims that the rate of interest is fixed and *dependent* on the quantity of money and liquidity preference. Thus, the rate of interest is fixed and is not independent, regardless of the fact that what determine the rate of interest are independent elements. Independent fundamentally based on the behavioral or psychological patterns of the society. In the long-term, these patterns tend to be fixed but independent variables will fluctuate with changes in the sociological aspects of the

43. Hansen, *A Guide to Keynes*, pg. 165

economy. Hansen regards economic science as the search of the determinants of the income and employment and that only the main determinants can be discovered due to the sheer complexity of the modern market. Keynes states that the reason economic science is so complex is mainly due to the fact that all determinants are subject to change. The only way to truly expand the knowledge of economic science is by discovering, isolating, and evaluating the subjective determinant factors. Hansen goes on to point out that simple changes in investment, regardless of what individuals see as a return from that investment, may be spurred by certain conditions in high capital intensive sectors of the market. That large volumes of investment will increase the costs of the production of capital goods and will have an affect of lowering the marginal efficiency of investment. Hansen argues that wage-rates are sticky and that any change in money wages is quite difficult. If wage-rates were not sticky there would be “*violent 'instability in the price level.'*” Also, Hansen believes that flexible wage-rates, under full employment, would produce inflation.

B) Henry Hazlitt's View

Hazlitt starts off the analysis of this chapter of the *General Theory* by addressing Keynes' belief that there are certain economic elements that can be labeled as independent or dependent; that certain relationships may vary yet others do not. Hazlitt rejects this position by arguing that economics is the study of human valuations, human decisions, and human action. All human relationships have potential of changing and that there are no given relationships in economic analysis. Each element must be closely evaluated and understood as a factor of possible constant change. Hazlitt states that the Keynesian *independent* and *dependent* variables do not apply in the general and should be applied, if used at all, in evaluating specific economic phenomena; that through the testing of hypothesis, economists can deduce a specific relationship between factors. Hazlitt writes that

“in any case, it is a characteristic of economic problem-solving that what is 'given' is determined by the nature of the problem. Conclusions regarding what is dependent and what is independent, what is cause and what is effect, are determined by our arbitrarily selected starting point.”

Hazlitt also disagrees with the Keynesian notion that the level of national income and unemployment are related. Internationally, the United States may have greater productivity with large unemployment compared to other countries that may have full employment. Also, when a worker in

the market is fired, they tend to be the least efficient worker and *vice-versa* when an entrepreneur is hiring a worker. As a nation reaches full employment, productivity per worker tends to fall. Likewise, as a nation moves away from full employment, productivity tends to rise. In addition, productivity may rise with a fall in employment as certain technologies are adopted. These are all instances in which the “national income” may rise or fall without any direct correlation to the number of individuals employed; that increased employment does not necessarily imply an increased national income level or *vice-versa*. Hazlitt states that

“Changes in the rate of consumption are, in general, in the same direction (though smaller in amount) as changes in the rate of income’ (Keynes’ italics, p.248.) In other words, when a man’s income rises, he consumes more; the more his income rises, the more he tends to consume; and when a man’s income falls he consumes less! Tremendous discovery, which deserves all the italics that Keynes can give it.”⁴⁴

Often times in the *General Theory*, yet mainly in this chapter, Keynes describes an unstable relationships between output and employment. This relationship is not clearly defined and even Keynes himself seemed not to fully grasp the conclusions he tried to make. This phenomenon of stabilized unemployment, that Keynes so described, predominately existed in the United States during the 1930s and in Great Britain *circa* 1925 yet these occurrences have little to do with natural economic elements. Hazlitt argues that these occurrences are not due to the instability of free markets but the inflexibility of wage-rates in a downward direction mainly due to labor unions; a system of wage-rates that Keynes does nothing to attack in the *General Theory*. Hazlitt also strikes at the false cause and effect relationship Keynes identifies with money-wages and employment. Keynes regards a fall in employment with a fall in money wages ad *vice-versa* concerning a rise in employment. To begin with, it is not employment that affects the money wage-rates but it is money wage-rates that affect employment. Keynes thought processes is incorrect and the reversal of true economic phenomena.

Keynes also states that employment and wage-rates seem to move in the same direct; again, untrue. As unemployment ensues, the wages of those employed are high due to the increase in marginal productivity they contribute to the production processes. If the barrier to greater employment was removed in this scenario, wage-rates would *fall* as employment *rose*. This is not a movement in

44. Hazlitt, *Failure of the “New Economics,”* pg. 257

the same direction, as Keynes implies, and such a conclusion, as given in the *General Theory*, is counter-logical. Hazlitt does state,

“If, of course, it is prices rather than wage-rates that have been above the equilibrium level, or if for some reason wage rates have temporarily fallen below equilibrium level, then an increase in the demand for goods due to a fall in prices, or some other chance, or an increase in the demand for labor due to the low wage-rate will mean an increase in both employment and wage-rates.”⁴⁵

In this instance, this Keynesian relationship is may be temporarily correct but it is not a long-term phenomenon; these scenarios tend to be short and ineffectual. As Hazlitt points out clearly, this chapter is endlessly filled with logical and economic fallacies. It is not difficult to comprehend why, even in the *General Theory*, Keynes had such a difficult time trying to piece his doctrine together. These incorrect assumptions are some of the most crucial in the *General Theory*.

45. Ibid., pg. 260

Section VII:

Chapter 22 of *The General Theory*: The Trade Cycle

A) Alvin H. Hansen's Position

Hansen believes that marketplace fluctuations are inherent and have much to do with alterations in the marginal efficiency of capital. The marginal efficiency of capital is dependent on the forecasted yields from investments and the total costs of these investments. Hansen goes on to point out that “*fluctuations in the rate of investment are mainly due to changes in R [total sum of prospective annual yields] and Cr [total cost of the new investments in capital goods].*”⁴⁶ Keynes states that a decline in R is the fundamental cause of a fall in the marginal efficiency of capital. That said, he also points out that rising costs also play a vital role in a decline in the marginal productivity of capital. The R series, as Hansen describes, is based on the volume of capital goods as well as the psychological faith of entrepreneurs in positive future yields. Hansen states that nearing the final stages of an expansion phase, psychological factors, such as entrepreneurial optimism, may prolong the boom phase in spite of excess capital, rising costs, diminishing returns, and rising interest rates. Hansen writes that the fundamental stages of the trade cycle are:

- 1) Individuals begin to fear diminishing prospective yields. This fear is sparked by a decline in present yields.
- 2) Present costs of capital goods then increase. This creates a smaller differential in the prospective yields of the future production. It is now increasingly difficult to gain a profit from the production process.
- 3) Decreases in the marginal efficiency of capital cause asset holders to place wealth into more liquid assets, such as cash.
- 4) The increase in “liquidity preference” has an upward affect on the rate of interest cutting off further investment.

Taking these facts into account, Hansen states that the initial cause of the shift to more liquid assets is sparked by a decrease in the marginal efficiency of capital. This fall in the marginal efficiency of capital is prompted by rising costs of capital production and a decline in prospective future increases in production. Hansen then points out the importance of confidence in the prospective yields of the market. Though Hansen partly connects the duration of the trade cycle with fluctuations in

46. Hansen, *A Guide to Keynes*, pg. 207

optimism and pessimism in economic actors, such as investors and consumers, the root of the duration of cycles have more to do with the rate of economic growth. Hansen writes that the *shorter the lifespan* of excess capital, the *shorter the depression*. Also, the faster the rate of economic growth, the easier it is to free the market from an upcoming depression. Inventories play a significant role in the length of the depression. The greater the costs of storing surplus inventory, the longer the duration of the depression.

Hansen goes on to identify the specific level at which capital is maximized but not overproduced. That there is a ceiling to investment that exists and when investment exceeds that point there can be growing unemployment or that the rate of return of capital is zero; that capital produces equal to its cost. At such a stage, full employment is existent. The likely outcome of an investment boom is that growing unemployment will occur and that this is fueled by the misplaced expectations of investors at the peak of a boom. In order to level out these natural trade cycles, Hansen argues that a flexible interest rate can be quite beneficial in that it will ease the cycles and could bring the country to full employment. Yet even Hansen points out that Keynes is not sure of this theory and recognizes that it may be incorrect. Under this theory, the 1929 boom could have been prolonged by a low interest rate maintained by the monetary authority. Hansen strongly disagrees here with Keynes by stating that stock yield were quite low and that even low interest rates would not have prolonged the boom. Hansen then goes on to line out Keynes' explanation of trade cycles:

“1) *The cycle consists of fluctuations in the rate of investment.*
2) *Fluctuations in the rate of investment are caused mainly by fluctuations in the marginal efficiency of capital.*”

Hansen argues that changes in the liquidity preference schedule may be caused by changes in the rate of interest and alterations concerning the marginal efficiency of capital. These liquidity preference schedule fluctuations have a tendency of also affecting and adding to the severity of trade cycles. In addition, fluctuations in the marginal efficiency of capital arise from changes in the cost and future yields of current capital.

Hansen goes on to point out that a decline in the prospective yields of capital at the height of an investment boom is fueled by the realization of overproduced capital goods. Pessimism may then break in, lowering even further any prospective yields and thus, reducing the marginal efficiency of capital further. Flexible interest rates, specifically targeting low interest rates, may have the affect of

stabilizing current and future trade cycles. Keynes did believe that the boom phase was necessary for growth but that, through ever-changing monetary policy, full employment could be reached; this would effectively end depressions and negative cycles. This is mainly in response to other economists of the time that believed the boom phase caused the bust phase. Hansen also holds this position and shows no signals of disagreement with Keynes on this aspect of the trade cycle.

B) Henry Hazlitt's View

Hazlitt begins by first enlightening the reader of the confusion surrounding concerning the use of “the marginal efficiency of capital” in the *General Theory*. “The marginal efficiency of capital” has been used in various different ways throughout the *General Theory* and has been equated with *current yield from capital*, *expected future yield from capital*, and *entrepreneurial profits unrelated to the current amount of capital*. One of the most important rules of thumb when dealing with any type of serious analysis is that all terms must be defined, non-ambiguous, and coherent. Keynes seems to neglect these common standards and writes in such a confusing and incoherent manner that by the end of the *General Theory* various terms, such as the marginal efficiency of capital, have been used to identify different phenomena.

Hazlitt is quite skeptical about the insinuation made by Keynes that the business cycle tends to be regular and are easily measurable. The initial problem with this is the methodology used in measuring trade cycles; individual company or industry specific indexes may not give a clear picture of the problem or if a cycle is even in effect. A more credible solution are to use indexes that are more general, include different industries, and evaluate certain goods that are easily affected by changes in the state of the economy. Moreover, in the analysis of the business cycle it is important to not include seemingly external phenomena such as war, natural disasters, or cultural events. In order to have a clear analysis of business cycle theory, one must give ample room for the exclusion of these external factors. Keynes makes a theoretical conclusion that business cycles are influenced mainly by a sudden decline in the marginal efficiency of capital and not due to rise in the interest rate. Keynes states that due to a decline in the prospective yields from capital, there is a fall in the marginal productivity of capital; in essence, businessmen fear a declining profits. This simple psychological factor could not be the main reason for trade cycles; changes in psychological outlooks of the market are not arbitrary but are rooted in true economic occurrences. Keynes, as Hazlitt points out, is quite unclear in this regard which makes the reasoning in his analysis even more incomprehensible.

As Hazlitt analyzes in this chapter, he finds that Keynes does not believe the cause of the cycle

is fluctuating interest rates yet they can play a significant role in lengthening the period of the expansion cycle. By keeping the rate of interest low, Keynesian doctrine believes that investment will be spurred and employment will ensue bringing an end to a recession or depression. Hazlitt concludes that this is incorrect. It is when interest rates are kept artificially low that resources are misallocated *vis-a-vis* malinvestments that would have not otherwise taken place. As these investments collapse, the rate of interest increases and the naive blame the latter as the cause and not the effect. Hazlitt, goes on to state,

“Insofar as Keynes presents any clear theory of the trade cycle whatever, it is the theory that the economy cannot be trusted to private hands, cannot be trusted to the free plan of the market, but must be put into the hands of the government bureaucrats, who are apparently to be regarded as ex officio. As perfectly rational, completely informed, incorruptible, and free from any taint of political interest.”⁴⁷

Keynes is so easily accepting of government control without clearly understanding the role of government and lack of incentives present when bureaucrats attempt to control economic phenomena. Keynes essentially believed that investment can not be left to the private individual and that government needs to step in and not only monitor investment decisions but take an active role in aggregate investment. This belief is quite revealing and serious for whoever controls the rate of investment also control the direction of investment and production. Hence, whoever controls the investment funds in an economy controls the direction of production. Such an important role should not be left to government officials but to the free market and private initiative. Returning to Keynes' belief that trade cycles are regular, Hazlitt argued that such statements are not backed up by any statistical evidence. Hazlitt makes the statement that there are true reasons for the occurrence of the business cycle. The trade cycle begins by a credit expansion that brings down the rate of interest and encourages risky investment ventures. By allowing certain individuals to borrow funds due to an artificially low rate of interest, investments that would not have occurred will now take place. The boom phase can be categorized as an increase in these unstable investments. Hazlitt also adds that a timely increase of wage-rates could have the affect of limiting the severity of the boom.

Keynes argues that those individuals who deny a lower interest rate are individuals who do not

47. Ibid., pg. 323

desire full employment. Hazlitt states that no economist desires to raise the rate of interest in order lower employment but instead, to cool of the inflationary trends and limit the extent of malinvestment on the market. Keynes failed to see that the rate of interest is a market phenomena. Though the monetary authority “controls” the money supply, the value of money and the value of investment is determined by the market. What Keynes failed to comprehend is that the rate of interest and productivity of monetary assets are controlled by the economy; perpetual inflation will not cure a depression. Only when government removes the monopoly mint and returns the determination of money to the market economy will business cycles disappear. For what causes malinvestment, failure of stocks, and decreased productivity is the over issue of credit by the monetary authority and the existent differential between investment and genuine savings.

Conclusion

Though the *General Theory* may have changed the face of mainstream economics for now, the arguments against the Keynesian doctrine are quite formidable. It is unwise for the mainstream to disregard the analyses of such individuals as Hazlitt and Hutt⁴⁸ and cast aside the fallacies of the Keynesian paradigm. This paper has portrayed the holes in the Keynesian doctrine, as argued by Hazlitt, and has upheld the *General Theory* as a masterpiece, as Hansen would have the reader believe. Both views have been brought to the table, both analyses have been thoroughly broken up. It is now up to the reader to decide whether Hazlitt's analysis or Hansen's analysis is correct for the amount of theory involved in such a discussion is far beyond the space that can be allotted for it in this essay. That said, one thing is for certain, if economic science is to have consistency then all elements should be evaluated and the Keynes' doctrine dismantled. For the historic failure of the Phillips curve⁴⁹ is simply the beginning of the end for Keynesianism.

48. William H. Hutt was a British economist who wrote extensively on the fallacies of the Keynesian paradigm. One of his more famous analysis is *The Keynesian Episode* that can give great insight into any individual looking into this field.

49. The Phillips curve is a diagram adopted at one point in time by the Keynesian school to describe the relationship between unemployment and inflation; it was created by A. W. Phillips. The curve illustrated a negative relationship between inflation and unemployment (*i.e.*, as inflation increased, unemployment decreased). This diagram was disregarded after the stagflation incident in the 1970s when there was growing unemployment and inflation was at record highs. There has recently been a movement by the Keynesian school to bring back the Phillips curve with a new look on the same old relationship.

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