

## ANDERSON, HAZLITT, AND THE QUANTITY THEORY OF MONEY

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HENRY HAZLITT, ECONOMIST AND journalist, played a decisive role in the postwar presentation and dissemination of Austrian ideas in America. Not only was he Ludwig von Mises's friend and editor, he was also a book reviewer at the *New York Times* and (later) columnist for *Newsweek*. From these positions, he brought broad attention to the works and ideas of Mises and Hayek to an English-speaking world that might have otherwise tended to disregard the writings of these Austrian exiles as coming from another time in another land.

However, Hazlitt's intellectual formation did not begin with his association with Mises. Rather, he had already steeped himself in the works of American proto-Austrians, in particular, those of Benjamin Anderson, who was an economist at Harvard University, the National Bank of Commerce, and Chase Manhattan Bank. Because Hazlitt's work became the bridge on which the Austrian School crossed from the old world to the new, the influence of Anderson on Hazlitt—particularly in the area of monetary theory—becomes a critical if heretofore unexplored chapter in the history of ideas.

Anderson, along with Mises and Philip Wicksteed, was to exert a profound influence on Hazlitt.<sup>1</sup> Anderson, the second of four children, was the son of businessman Benjamin McLean Anderson. He received his A.B. from the University of Missouri in 1906, and his A.M. from University of Illinois in 1910. The following year, Anderson received his Ph.D. from Columbia University. His doctoral dissertation, published under the title *Social Value*, was the first of his two major theoretical works, the other being *The Value of Money*, published in 1917 while he was a professor of economics at Harvard.<sup>2</sup>

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<sup>1</sup>In Hazlitt's unpublished autobiography, *My Life and Conclusions*, he names Wicksteed, Mises, and Anderson as those to whom he owes intellectual debts. Henry Hazlitt Papers, Foundation for Economic Education.

<sup>2</sup>Benjamin Anderson, *Social Value* (New York: Houghton Mifflin, 1911); and Benjamin Anderson, *The Value of Money* (New York: Macmillan, 1917).

By 1918, Anderson had left his academic post at Harvard and joined the National Bank of Commerce, where he was the editor of the *Commerce Monthly*. Yet it was later, during his tenure at the Chase Manhattan Bank, that Anderson gained name recognition and the opportunity to spread his anti-inflationist message to a wider audience. As editor of the bank's *Chase Economic Bulletin* until 1937, Anderson published scathing critiques of all spurious monetary schemes, from inflationism to devaluation.

It was during the 1920s and early 1930s that Hazlitt's personal and intellectual relationship with Anderson came to greatly alter his thinking in both economic and political terms. In fact, before he was conversant in the works of Say, Menger, Hayek, and Bohm-Bawerk, Hazlitt was reading the books and articles of Ben Anderson. Before Hazlitt was an avowed Austrian and a disciple of the Misesian tradition, he was Andersonian. Hazlitt's contact and relationship with Anderson ("Mac" to Hazlitt) lasted from the early 1920s until Anderson's death in 1949. It was, in fact, through Anderson's book *The Value of Money* that Hazlitt first learned of the work of Mises.<sup>3</sup> Here, in the work of Anderson, Hazlitt received his first dose of anti-fiat, anti-Keynes, and anti-quantity-theory thinking.

By the mid-1920s, after almost ten years of writing on economics and finance, Hazlitt still had a rather unrefined understanding of the market. Although he favored capitalism, there is little evidence that he did so with the gusto and consistency that came to typify his later writings. In a 1924 letter to Anderson, Hazlitt admits, "when I first opened [Anderson's *Value of Money*] I had at the back of my mind some crude form of quantity theory which balanced money against goods and paid scant attention to such subtleties as velocity of circulation." This is an interesting statement coming from Hazlitt, for some years later he continued to pay "attention" to the velocity of circulation only insofar as he found it a specious and misleading doctrine. "I finished [*Value of Money*]," Hazlitt wrote "with a rejection of

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<sup>3</sup>In his unpublished autobiography, p. 66, Hazlitt writes,

I came to know of von Mises indirectly through Anderson. In his *Value of Money*, Anderson reviewed a large number of other writers, American and foreign, on the subject. Most of his judgments were severe; but when he came to *The Theory of Money and Credit* (which he reviewed from the original German edition) he wrote: 'In Mises I find unusual power and insight.' This was my first knowledge of Mises's work."

I might note that Hazlitt quotes the Anderson passage incorrectly. In the actual copy that Hazlitt first read, Anderson writes: "In von Mises there seem to me to be very noteworthy clarity and power." Anderson, *The Value of Money*, p. 100.

the quantity theory and an acceptance of the concept of value as an absolute quantity."<sup>4</sup>

In a series of short but brilliant articles that appeared under the auspices of the Chase Manhattan Bank, Anderson exposed and crushed the fallacies of Fisherian "quantity theory" and the incipient doctrines of Keynes. In this respect, Anderson was the Hazlitt of his day—writing easily accessible, yet devastating critiques of increasingly technical economic theories.<sup>5</sup> Anderson was equally at home in the premier economic journals of the day as he was in the magazines and bulletins that arrived at the public's doorstep.

Although rightly praised by Austrians for his defense of free markets and for exposing the destruction caused by cheap money policies, Anderson was un-Austrian in many important respects. In his earlier works especially, he diverged markedly from the Mengerian subjectivist concept of value. In his first book, *Social Value*, Anderson writes, "As a theory of value, as a theory to explain the nature and origin of value, I am convinced that the Austrian theory is utterly and hopelessly inadequate."<sup>6</sup> And again: "[T]he abstract individual factors which the Austrians have substituted are . . . helpless in explaining the motivation of social activity."<sup>7</sup>

Anderson believed that in its methodological individualism, the Austrians removed man from society, and thus denied acting man the framework within which his values are formed. He writes:

[The Austrians] abstract the individual mind from its connection with the social whole, and then abstract from the individual mind only those emotions which are directly concerned with the consumption and production of economic goods; this abstraction is necessitated by the individualistic, subjectivist conception of society, which, growing out of the skeptical philosophy of Hume, has dominated economic theory ever since.<sup>8</sup>

This, however, does not detract from his analysis and devastating critique of Fisher's quantity theory—a critique that formed the basis of Hazlitt's later criticisms of Milton Friedman's monetarism.<sup>9</sup>

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<sup>4</sup>Henry Hazlitt to Benjamin Anderson, September 8, 1924, Henry Hazlitt Papers, Foundation for Economic Education.

<sup>5</sup>I would like to thank Dr. Richard Ebeling for making this comparison.

<sup>6</sup>Anderson, *Social Value*, p. 188.

<sup>7</sup>*Ibid.*, p. 199.

<sup>8</sup>*Ibid.*, pp. 197–98.

<sup>9</sup>See Henry Hazlitt, "Where the Monetarists Go Wrong," in *The Inflation Crisis and How to Resolve It* (Irvington, N.Y.: Foundation for Economic Education, 1995).

Starting with the very basic premises of Fisher's doctrine, Anderson's step-by-step analysis of the quantity theory's corpus totally demolished any sympathy in Hazlitt's mind as to its legitimacy.<sup>10</sup> The simplicity with which Fisher and the subsequent monetarists sought to deal with complex and interrelated economic phenomena with mathematical and mechanical relationships struck Anderson as qualified nonsense. He writes:

Economics is a complicated science. Economic phenomena are tangled and complex. The theory of value and prices is difficult, not easy. A sound theory of value must rest in a study of human nature, of social psychology, or social organization. . . . It is one of the vices of the quantity theory of money that it tends to check realistic analysis and to arrest thinking.<sup>11</sup>

Anderson's point, and one that is agreeable to Austrians, is that, because of the subjective nature of the individuals acting within the market framework, no definite, concrete ratios can be defined by mathematical formulas. Individuals who prefer one good at one moment may reevaluate and desire another good the next moment. There are general tendencies in an economy (e.g., if the amount of credit in an economy increases, *ceteris paribus*, there will be a general trend towards higher prices), but it is absurd to attempt to capture these interrelationships with an equation like  $MV=PT$ . He sums up the shallowness of the quantity theory by writing: "Money and bank credit had expanded, prices were high, the phenomena were explained. Why look further?"<sup>12</sup>

Hazlitt argued that, in its most basic form, the fundamental property of the "mechanical quantity theory of money" (as he called it) was self-evidently true. "It is true that there is a close relation between the outstanding supply of money and the buying power of the individual monetary unit."<sup>13</sup> If the amount of currency circulating in an economy doubles overnight, it is certain that prices would rise by some amount. He writes:

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<sup>10</sup>I surmise that Anderson's *Value of Money*, his careful book-length analysis of Fisher, served as the basis for Hazlitt's later line-by-line refutation of Keynes. See Henry Hazlitt, *The Failure of the "New Economics": An Analysis of the Keynesian Fallacies* (New Rochelle, N.Y.: Arlington House, 1973); cf. John Maynard Keynes, *The General Theory of Employment, Interest, and Money* (New York: Harcourt, Brace, 1936).

<sup>11</sup>Benjamin Anderson, "The Gold Standard versus 'A Managed Currency,'" *Chase Economic Bulletin* 5, no. 1 (March 23, 1925).

<sup>12</sup>*Ibid.*, p. 4.

<sup>13</sup>Hazlitt, *The Inflation Crisis and How to Resolve It*, p. 170.

It is perfectly true, to begin with, that the quantity of money affects the value of the monetary unit, just as the quantity of wheat, say, affects the value of an individual bushel of wheat. In both cases, an increase of supply, other things being equal, reduces the value of a given unit.<sup>14</sup>

In this regard, both Hazlitt and Anderson were quantity theorists (and, for that matter, almost all good economists are crude quantity theorists). Hazlitt actually praised the monetarists for recognizing that "money does matter," writing:

It is with considerable reluctance that I criticize the Monetarists, because, though I consider their proposed monetary policy unfeasible, they are after all much more nearly right in their assumptions and prescriptions than the majority of present academic economists.<sup>15</sup>

The problem, as Anderson and, later, Hazlitt understood it, is that there is no fixed relationship or ratio that exists between the quantity of money and the price level. Hazlitt offers the example of the German inflation of the 1920s to disprove the simplicity of the quantity theory. In the first stage of the inflation, the supply of money rises faster than do prices, as consumers expect this new supply of money to slow down. As it becomes apparent that the spigot is permanently open, stage two occurs in which prices rise with the volume of money. If looked at as a snapshot, stage two mimics the quantity theory's hypothesis. In stage three, prices still climb even as the rate of monetary creation subsides. At this point, producers and consumers have lost all confidence in their government's ability to slow the price increases, so they continue to buy in hope of squeezing all buying power out of their dollars. Thus, they bid up the price of goods, and it becomes a self-fulfilling event.<sup>16</sup>

The idea of stability of the general price level was paramount in the minds of the monetarists. Because of the instability of gold, planners would manage the supply of paper money in the economy to smooth out the fluctuations in the price level, thereby stopping the appearance of the business cycle. To Anderson, the suggestion that currency was something that could be stabilized, managed, or planned was spurious. Part of his objection to such a doctrine was his skepticism of central planning. As he pointed out:

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<sup>14</sup>Henry Hazlitt, "Velocity of Circulation," in *Money, the Market, and the State*, ed. Nicholas Beadles and Aubrey Drewry (Athens: University of Georgia Press, 1968), p. 37.

<sup>15</sup>Hazlitt, *The Inflation Crisis and How to Resolve It*, p. 73.

<sup>16</sup>*Ibid.*, pp. 56–71.

An infinite intelligence with infinite powers at its disposal could arbitrarily straighten out [issues of stability]. Human intelligence, as at present organized, cannot undertake it by conscious public planning. We have no machinery for accomplishing it except the machinery of the market.<sup>17</sup>

Anderson stressed the divergence of needs between "sound banking" and "public finance." In times of turmoil, it is naïve at best to assume that "price stability" will be maintained at the expense of political necessity. He writes:

A federal government with independent executive, judiciary, and legislature, with the legislature working through separate committees each concerned with a particular problem, with independent states with autonomous local governments, sees economic life piecemeal and not as an organized whole. Effective economic planning would have to be preceded by a complete centralization of our government. Democracy, local self-government, and individual rights protected by the courts would have to be done away with.<sup>18</sup>

Government planners and the politicians who control the purse strings are captured by those who call for increased wages and higher prices.

If such "management" of currency was allowed to occur, Hazlitt argued, money would simply become a "political football." The primary benefit of the gold standard is the lack of control by any central authority over the value and purchasing power of each unit of currency. Hazlitt argued from a Public Choice standpoint, for he understood that:

The politicians' own objectives will be those that seem best calculated to keep themselves in power. The particular policy they will assume is most likely to keep them in power is to keep increasing the issuance of money.<sup>19</sup>

Money, like all other goods, is best when its supply, quality, and price are determined on the free market, not in the cubicle of some Fed economist.

Even if every member of the government, at all times, was committed to the notion of price level stability, such a goal still could not be achieved. Anderson, like Hayek, described prices as signals:

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<sup>17</sup>Anderson, "The Gold Standard versus 'A Managed Currency,'" p. 8.

<sup>18</sup>Benjamin Anderson, "Governmental Economic Planning," *American Economic Review* 30, no. 1 (March 1940): 252.

<sup>19</sup>Hazlitt, *The Inflation Crisis and How to Resolve It*, p. 176.

From the point of view of the economist, it is the function of prices to tell the truth about what is going on in the fields of production and consumption, and to correct maladjustments and to bring about a re-equilibration of the productive activities when they get out of balance. The facts which lie behind prices may be bad facts, but we do not help the situation by disguising them.<sup>20</sup>

The irony not lost to Anderson was that it was *because* of the lack of stability in prices that *general* economic stability occurred. Freely fluctuating prices in a market economy allow capital and finished goods to find their way to the most highly valued (and consequently to the most productive) uses in society. Free-market prices bring production and consumption into line. He writes:

If one kind of commodity is being produced in excess and another kind in deficiency, the price of the scarce article rises and the price of the excessive article declines. Labor and capital then tend to shift from the production of the superabundant article to the production of the scarce article. Consumption of the scarce article is checked by the rising price, consumption of the superabundant article is encouraged by the falling price. The balance is restored. Real stability is brought back to the trade of the world when the world as a whole is in balance.<sup>21</sup>

An industrial situation is stable when goods are produced in the right kinds and the right amounts for markets, so that supply and demand are equated and steady production can go on with a regular clearing of the markets. Under the price system, the mechanism for bringing about this balance is to be found, not in public planning by a socialistic government, but in price fluctuations in free markets.<sup>22</sup>

What's more, concentrating on the overall price level misses the forest for the trees. Individual entrepreneurs and consumers don't buy, produce, or sell based on "general" prices. It is the "individual price relationships that actually influence the use of resources and the production of goods."<sup>23</sup>

In addition to arguing that price changes and fluctuations are a necessary component of a healthy, dynamic, market economy, Anderson articulated the difference between price changes that originate on the goods side and price changes that originate on the

<sup>20</sup>Anderson, "Governmental Economic Planning," p. 253.

<sup>21</sup>Anderson, "The Gold Standard versus 'A Managed Currency,'" p. 8.

<sup>22</sup>*Ibid.*, p. 7.

<sup>23</sup>Richard Ebeling, "Monetary Central Planning and the State, Part IV: Benjamin Anderson and the False Goal of Price-Level Stabilization," *Freedom Daily* (April 1997): 7.

money side of the market. Innovations in production and the manufacture of goods have lowered the cost to consumers. In this sense, wage decreases accompanied by lower prices don't harm prosperity.

A fall in the prices due to a forced appreciation of money may be depressing in its effects upon industry and upon the burden of debt. A fall in prices, however, which is due to a great increase in the physical volume of goods produced is a different matter.<sup>24</sup>

Inflationary (or, for that matter, deflationary) price movements brought about solely by the manipulation of currency by the monetary authorities can have drastic consequences on the economy. Should consumers find the value of their currency shrinking with no change in general output and production, consumption will be encouraged, despite the level of higher new prices. If my dollar can buy three loaves of bread today and I forecast that tomorrow it will buy only two loaves, I will surely make my purchase today rather than give up the additional loaf tomorrow. As Anderson writes: "Extravagance rather than economy is encouraged by rising prices."<sup>25</sup>

Hazlitt followed much the same line of thought. There was certainly a difference between changes in the purchasing power that occurred on the goods side and those originating on the money side of the economy. Hazlitt remarked that:

[I]n a free and flexible economy prices would be falling because productivity was increasing, that is, because costs of production were falling. There would be no necessary reduction in real profit margins. The American economy has often been prosperous in the past over periods when prices were declining.<sup>26</sup>

Hazlitt's primary concern was inflation—an expansion of the money supply brought about by easy money policies. Price declines caused by increased industrial competitiveness and/or technical innovations should be welcomed.

Doubtless many long-run price movements—that is, tendencies extending over more than a decade—are the result of changes in the supply of gold itself; but most price changes—and this applies particularly to those of the last few years—are the result of changes in the supply and demand for goods.<sup>27</sup>

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<sup>24</sup>Anderson, "The Gold Standard versus 'A Managed Currency,'" p. 23.

<sup>25</sup>Ibid., p. 8.

<sup>26</sup>Hazlitt, *The Inflation Crisis and How to Resolve It*, p. 82.

<sup>27</sup>Henry Hazlitt, "Rubber Money and Iron Debts," *The Nation* (December 23, 1931): 692.



Why should consumers pay more for goods, all in the name of "price stability"?

In 1911, Irving Fisher wrote:

The velocity of circulation, or rapidity of turnover, is simply the quotient obtained by dividing the total money payments for goods in the course of a year by the average amount of money in circulation by which those payments are effected. This velocity of circulation for an entire community is a sort of average of the rates of turnover of money for different persons.<sup>28</sup>

Chapter 12 of Anderson's *Theory of Money* argues that this concept of "velocity of circulation" has very little importance to the science of economics, and certainly little impact on the level of prices. He writes:

To me, "velocity of circulation" seems to be a mere name, denoting, not any simple cause or small set of causes, which can exert a specific influence, but rather a meaningless abstract number, which is the non essential by-product of a highly heterogeneous lot of *activities of men*, some of which work one way, and others of which in another way, in affecting prices.<sup>29</sup>

The "circulation" of currency was the effect, not the cause, of price fluctuations.

Hazlitt followed Anderson, and indeed went further in his objection to the whole notion of "velocity." First, money does not literally "circulate," argued Hazlitt. It is at all times exchanged for goods and services on the market. Thus, money's circulation increases as goods circulate: "Therefore the 'velocity of circulation' of money can never be any greater than the 'velocity of circulation' of goods."<sup>30</sup>

In Fisher's  $MV=PT$  equation, velocity acts separately and apart from  $T$ . Yet it is the purchase and trade of goods that directly influenced  $V$ . Hazlitt concludes: " $V$  and  $T$  cannot be separated. Insofar as there is a causal relation, it is the volume of trade which determines the velocity of circulation of money rather than the other way around."<sup>31</sup>

Once individuals lose faith in the value of currency, the rate at which they attempt to spend it increases. Hazlitt also argued that the expected value of a unit of currency can affect  $V$ . Should a rapid

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<sup>28</sup>Irving Fisher, *The Purchasing Power of Money: Its Determination and Relation to Credit Interest and Crisis* (New York: Macmillan, 1926), p. 17.

<sup>29</sup>Anderson, *The Value of Money*, p. 204; emphasis in original.

<sup>30</sup>Hazlitt, "Velocity of Circulation," p. 38.

<sup>31</sup>*Ibid.*, p. 39.

inflation set in, a holder of cash would be wise to spend it for tangible goods. The valuations of consumers and producers with regard to currency are always changing. During inflations, when the purchasing power of currency is decreasing,  $V$  may increase, but if inflation is rampant, sellers as much as buyers will be wary of accepting the depreciating currency. In a deflationary period, the opposite might occur, as individuals wait for the currency to strengthen in regard to the amount of goods they can secure.<sup>32</sup> In addition, money is always in *someone's* hand. For consumers to spend and "circulate" money at a rapid rate, there needs to be a party willing to accept the currency. That is, the average per capita holding of currency will remain the same.<sup>33</sup>

Hazlitt favored a 100 percent reserve gold standard. This is one of the few theoretical differences between Hazlitt and Mises. While Hazlitt argued that competition would induce banks to consistently lower their reserve ratio, Mises saw the competitive forces as having the exact opposite effect—only through free banking could solvency be assured.<sup>34</sup> For Hazlitt, a "free banking" system in which private banks are free to print fiduciary media without a concomitant increase in their holdings of gold is just as likely to give rise to the boom/bust phenomenon as is a government.

With regard to Anderson, it is difficult to precisely define his position on the subject. Certainly he favored a gold standard, yet at times he lauded the Federal Reserve Bank for its role in fostering "elasticity" in the monetary system.<sup>35</sup> Anderson, like Hazlitt, was skeptical of paper money, and looked at all new schemes and "reforms" as wholly unjustified if money, paper or otherwise, was not directly redeemable into gold. In a 1925 *Chase Economic Bulletin*, Anderson wrote: "There are diseases of money and credit. Irredeemable paper money is diseased money. It is cured by gold redemption accompanied by balanced budget and sound finances."<sup>36</sup> Anderson is explicit that paper money works only insofar as it is redeemable in gold or else the bank or government issuing the note *"has proved itself worthy of confidence by a satisfactory*

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<sup>32</sup>*Ibid.*, pp. 4243.

<sup>33</sup>Henry Hazlitt, "Notes on 'Velocity Circulation,'" Henry Hazlitt Papers, Foundation for Economic Education. Hazlitt wrote the paper in 1944 for the Mises N.Y.U. Seminar.

<sup>34</sup>For more, see Jude Blanchette, "Hazlitt on Gold," *The Freeman* (November 2004).

<sup>35</sup>Anderson, "The Gold Standard versus 'A Managed Currency,'" p. 18.

<sup>36</sup>*Ibid.*, p. 5.

record of redeeming the paper in gold on *demand*."<sup>37</sup> Yet I have not found a conclusive statement on behalf of Anderson to indicate how far he would take a gold standard.

Based on the preceding statements in conjunction with his other works, Anderson advocated a government-managed gold standard. Anderson was less of a theoretical economist (at least in the later stages of his writings), and, as such, was more worried about the practical and pragmatic. He sought a return to a classical gold standard, or at the least the abatement of the cheap money policy that came to typify the 1920s. He was not doctrinaire, nor was he an ideologue. He had distaste for inflation and spurious notions of "price stability," but it would be untenable to try and label him *laissezfaire* in regard to banking. Here, Anderson's non-interventionist beliefs extended only so far:

It is a proper function of government to maintain competition, to prevent corners, combines, monopolies, manipulative raids in the stock exchange or in the commodity exchanges—to prevent practices which keep the market prices from telling the truth, and which pervert the social co-ordination which the market supplies.<sup>38</sup>

The influence of Anderson on Hazlitt was profound and extensive. If the work of Mises and the Austrians shaped Hazlitt's theoretical acceptance of the subjectivist paradigm, it was Ben Anderson who injected in Hazlitt a radical distaste of inflationary policies and paper money. Therefore, to understand Hazlitt, one must be familiar with the work of Anderson. Unfortunately, this brilliant economist has been much neglected, even by Austrians. It is the modest hope of the author that this article will renew some interest in Anderson's life and work.

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<sup>37</sup>Benjamin Anderson, *Economics and the Public Welfare* (Indianapolis, Ind.: Liberty Fund, 1979), p. 414; emphasis added.

<sup>38</sup>Anderson, "Governmental Economic Planning," p. 251.

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