AMERICAN INSTITUTE for ECONOMIC RESEARCH

WEEKLY BULLETIN

July 20 1959

GREAT BARRINGTON MASSACHUSETTS

RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

Henry Hazlitt's Book

The Failure of the "New Economics"*

The author's primary purpose in writing this book was to analyze the Keynesian notions and expose the falacies in Keynes' arguments. As Mr. Hazlitt soon discovered, his self-imposed task was such as to make Hercules' cleaning of the Augean stables seem like an afternoon's picnic. Nevertheless, he persisted and has produced a comprehensive refutation of the Keynesian notions that we believe to be far more useful than any other that has appeared, at least from the viewpoint of many economists and most laymen interested in these matters.

This is the first book-length refutation of the Keynesian notions that can readily be understood by readers who have forgotten most of what they may once have learned about economics. The only other analysis of equal or greater scope with which we are familiar is the scholarly two-volume work by Arthur W. Marget. Of this we said more than two decades ago:†

"Although Dr. Marget's book will never be on the best-seller lists, it is one of the outstanding works of our time. He is entitled to the gratitude of students in the closely related fields of price and monetary theories. The distinctive features of this book are:

"1. Evidence of painstaking care in research that should serve as an example to everyone in the field.

"2. The wealth of valuable references and quotations from the works of earlier writers. Dr. Marget has been especially careful to trace the development of various concepts and theories.

"3. The objective and thorough manner in which Dr. Marget has dissected many fallacies, especially those found in the writings of Dr. John Maynard Keynes.

"What Dr. Marget has accomplished can be best described by comparing it to the work of a skilled surgeon. He has coolly and dispassionately operated on the body of received theory, has explained the details of the operation as he proceeded, pointing out the various anatomical relationships, and has successfully cut away several tumors which have been in large part responsible for the bad condition of monetary and price theories during recent years. He has promised to complete the operation and start the patient well on the road to convalescence in a second volume, which will be eagerly awaited by every student in the field.

"In the light of Dr. Marget's careful analysis and proof, Dr. John Maynard Keynes' contributions to the subject during recent years have been thoroughly discredited. This is indeed a body blow for the theories of the perpetual motion mongers who followed in Dr. Keynes' footsteps and whose Alice-in-Wonderland theories and bootstrap-lifting devices have been accepted by our gullible Government, for which 'gold bricks' have had such an irresistible attraction. It is too much to expect that Dr. Marget's work will immediately lead to a return to sanity on the part of those responsible for monetary manipulation in this country, but it is probable that his book will in the long run contribute to that desirable outcome."

That the task undertaken by Mr. Hazlitt should have been necessary more than 20 years after the first of Dr. Marget's two volumes was published is further convincing evidence that economics as a science still is in its unduly prolonged infancy. One obvious implication is that the field is still "overcrowded with intellects of similar constitution" to the "mathematically illiterate,"‡ in other words, that too many economists lack familiarity with simple logical reasoning, to say nothing of an adequate understanding of modern scientific method.

In order that readers of this review may better appreciate what Mr. Hazlitt has done, we insert the following quotations:

"Now though I have analyzed Keynes' *General Theory* in the following pages theorem by theorem, chapter by chapter, and sometimes even sentence by sentence, to what some readers may appear a tedious length, I have been unable to find in it a single important doctrine that is both true and original. What is original in the book is not true; and what is true is not original. In fact, as we shall find, even much that is fallacious in the book is not original, but can be found in a score of previous writers." (page 6)

"In short, we can draw all the beautiful supply and demand curves we like and cross them at the points that please us most. We can thus help to clarify ideas for college freshmen and even for ourselves. But we constantly run the danger of deceiving ourselves by our own diagrams; of giving ourselves the illusion that we

*Published by D. Van Nostrand Company, Incorporated, Princeton, New Jersey, 1959 ($7.50)

†*Research Reports*, "Book Review Supplement," October 3, 1938

‡Elbridge Sibley, *The Recruitment, Selection, and Training of Social Scientists*, Social Science Research Council, New York, Bulletin 58, 1948, page 73

know what we in fact do not know. For these supply and demand curves are merely *analogies, metaphors, visual aids to thought*, which should never be confused with realities." (page 102)

"But Keynes takes his whole preposterous theory so seriously that he virtually attributes the 1929 depression to it:

> In the United States, for example, by 1929 the rapid capital expansion of the previous five years had led cumulatively to the setting up of sinking funds and depreciation allowances, in respect of plant which did not need replacement, on so huge a scale that an enormous volume of entirely new investment was required merely to absorb these financial provisions; and it became almost hopeless to find still more new investment on a sufficient scale to provide for such new saving as a wealthy community in full employment would be disposed to set aside. *This factor alone was probably sufficient to cause a slump.* (My italics, p. 100.)

"There have been some pretty silly 'explanations' of the 1929 collapse, but it remained for Keynes to attribute it to the way in which corporations kept their books! Their new investment or lack of it, their actual amount of physical replacement in any given year, had in fact nothing to do with these accounting technicalities. It was determined by the actual physical need for replacement—or rather, more accurately, by the outlook (as it seemed to the corporation officers or directors) for *profits* from the replacement or new investment. A depreciation allowance may prove in practice to be either too great or too small. But entrepreneurs are not guided in their present decisions by their past expectations but by their present expectations. The drop in new investment was chiefly the *consequence* of the 1929 slump, not the cause." (page 126)

"One would suppose that Keynes would show the reader how these figures were obtained, what years they covered, etc., but he does nothing of the kind. On the contrary, he says that the marginal propensity to consume shown by these figures—60 to 70 percent—though 'quite plausible for the boom' are 'surprisingly, and, in my judgment, improbably low for the slump.' In other words, if the statistics do not fit in with Keynes' preconceptions, it is the statistics, not the preconcepions, that are to be suspected or thrown out. If the facts do not substantiate the a priori theory, so much the worse for the facts. Time and again Keynes tries to carry his point by sheer ex cathedra pronouncement. His evident success in carrying it off can only be attributed to the docility of academic opinion." (page 143)

"Keynes did not think that gold had value because *he* could not understand the source of its value. The fact that nearly all men through the ages have valued gold only indicated, in Keynes' eyes, that they were incurably stupid. But perhaps the stupidity is with the critics of gold. It is true, as those critics are always insisting, that you cannot eat it or wear it; but it is more satisfactory than custard pies or overcoats as a medium of exchange. And it is enormously more satisfactory as a medium of exchange and a store of value, as we shall see, than paper money issued in accordance with political pressures or bureaucratic whim." (page 155)

"And what is all this leading up to? The denouement comes in the final paragraph of the chapter:

> For my own part I am now somewhat sceptical of the success of a merely monetary policy directed towards influencing the rate of interest. I expect to see the State, which is in a position to calculate the marginal efficiency of capital-goods on long views and on the basis of the general social advantage, taking an ever greater responsibility for directly organizing investment (p. 164).

"So there you have it. The people who have earned money are too shortsighted, hysterical, rapacious, and idiotic to be trusted to invest it themselves. The money must be seized from them by the politicians, who will invest it with almost perfect foresight and complete disinterestedness (as illustrated, for example, by the economic planners of Soviet Russia). For people who are risking their own money will of course risk it foolishly and recklessly, whereas politicians and bureaucrats who are risking *other* people's money will do so only with the greatest care and after long and profound study. Naturally the businessmen who have earned money have shown that they have no foresight; but the politicians who haven't earned the money will exhibit almost perfect foresight. The businessmen who are seeking to make cheaper and better than their competitors the goods that consumers wish, and whose success depends upon the degree to which they satisfy consumers, will of course have no concern for 'the general social advantage'; but the politicians who keep themselves in power by conciliating pressure groups will of course have *only* concern for 'the general social advantage.' They will not dissipate the money for hairbrained peanut schemes in East Africa; or for crop supports that keep submarginal farmers in business and submarginal acreage in cultivation; or to build showy dams and hydroelectric plants that cannot pay their way but can swing votes in the districts where they are built; or to set up Reconstruction Finance Corporations or Small Business Administrations to make loans to projects in which nobody will risk his own money. There will never be even a hint of bribery, or corruption, or the gift of a mink coat to a minor official by the beneficiary of the loan. . . .

"This is the glorious vista that Keynes unveils. *This* is 'the new economics.'" (pages 184-185)

The foregoing quotations are a wholly inadequate sample of an excellent job. The book should be read in its entirety by everyone seriously interested in business-cycle analysis and money-credit policies. Although there are minor features that we should criticize as reflecting a less than comprehensive understanding on Mr. Hazlitt's part of the latest developments in methods of inquiry for the social sciences, we nevertheless recommend this book to our readers as one they will surely not want to miss. Moreover, we believe that many will desire to assist in giving it the widest possible distribution.

E. C. Harwood

What the Indicators Say

The indicators reported on below are seasonally adjusted, and the data are for June.

Average hours worked weekly by manufacturing production workers, a leading indicator, decreased slightly; employment in nonagricultural establishments and unemployment (inverted), both roughly coincident indicators, increased; retail sales, a lagging indicator, decreased very slightly; and interest rates on business loans, another lagging indicator, increased sharply.

Our previous appraisals of *up* for the trends and cyclical statuses of these series still apply, and the percentage of each group expanding remains unchanged from that of last week.

On the basis of data reported to the middle of July, the indicators forecast a continuation of the recovery trend.

* * * * *

The *Iron Age* composite price of No. 1 heavy melting steel scrap, not one of the indicators, was $39.17 per ton on July 14, unchanged from that on July 7.

SUPPLY

Residential Construction

Our index of residential construction decreased 21 percent in May, after having increased 9 percent in April, but was 25 percent more than the index for May 1958.§ The trend of residential construction, which has been upward since March 1958, weakened perceptibly in May.

The Engineering News-Record index of construction costs increased 0.6 percent in May, after having increased 0.8 percent in April, to a record 5 percent higher than that for May 1958. Success of the construction trade unions in obtaining substantial wage increases for periods of one or two years beginning July 1, seems to assure still further advances in the index.

Our index of the physical volume of residential construction, derived by dividing the seasonally adjusted dollar value of contract awards by the index of construction costs, decreased 22 percent in May, after having increased 8 percent in April. The May index was 19 percent more than that for May 1958.

The dollar total of contract awards for residential construction in the 48 States, as reported by the F. W. Dodge Corporation, was 19 percent more for April than that for April 1958; however, the total for May was 8 percent less than that for April and was 25 percent more than that for May 1958. The April total, both before and after seasonal adjustment, was the largest for any month of the new series. The contraseasonal decrease in the May total may reflect the initial impact of dwindling supplies of mortgage funds.

New privately owned nonfarm dwelling units started in May were at the seasonally adjusted annual rate of 1,340,000, about 4 percent less than the rate in April but 29 percent more than that in May 1958.

New homes financed under Government-sponsored programs totaled 44,600 in May, approximately the same number as in April and 39 percent more than in May 1958. New homes financed by conventional loans decreased in number 3 percent from April to May, when they were 24 percent more than the number so financed in May 1958.

Requests for VA appraisals increased 10 percent in May, while applications for FHA commitments decreased 2 percent. The combined number of homes proposed for construction through these requests and applications was 8 percent less than that in May 1958.

Although a housing bill, acceptable to the President, may yet be passed by Congress before it adjourns, such a bill would in all probability lack some of the unsound features of the recently vetoed bill. The FHA still has about $1,300,000,000 of uncommitted insurance authority, and loan repayments are freeing for reuse about $300,000,000 more every month. Recent legislation raising the maximum interest rate on VA loans from 4¾ to 5¼ percent may make such loans more attractive, but the higher rate is still less than that now prevailing in the mortgage market.

The outlook for rising construction costs and interest rates supports the widely expressed view that residential construction in the last half of 1959 will not exceed levels of a year earlier.

New Consumer Goods Per Capita

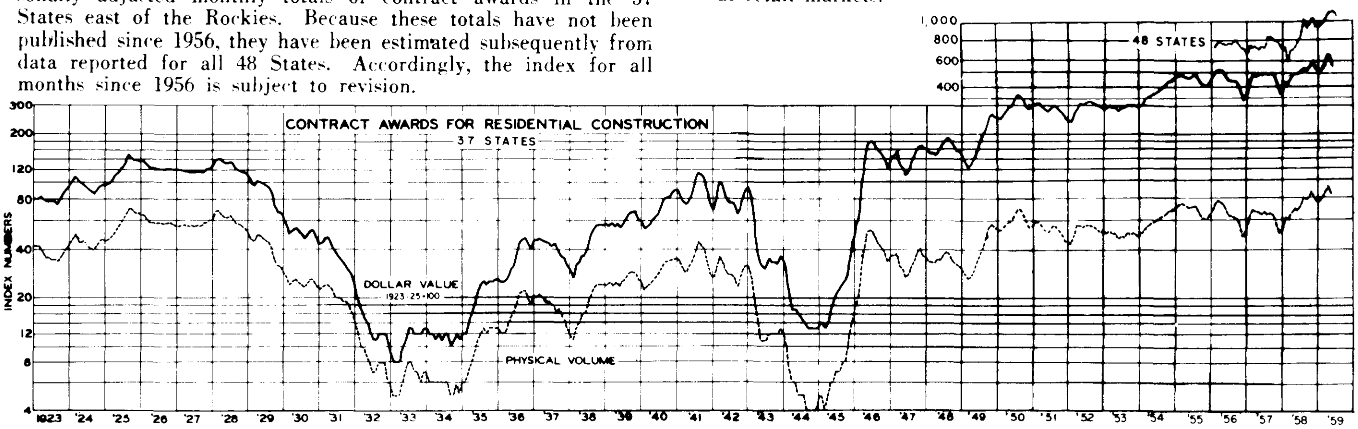
Our index of new consumer goods per capita for June increased slightly from that for May and was 16 percent more than that for June 1958.¶ Although the index has not yet surpassed the postwar levels previously attained in 1951 and 1955, it has exceeded the long-term trend for 3 months.

Production of consumer goods in June, unadjusted for population increases, was slightly more than that for May and was 17 percent more than that for June 1958. Relatively small increases in the production of automobiles, shoes, textiles, and furniture were almost offset by slight decreases in residential construction and other index components.

A steel strike of many weeks' duration would certainly affect production of consumer goods using large quantities of steel. Among the durable components of con-

§This index is a centered 3-month moving average of the seasonally adjusted monthly totals of contract awards in the 37 States east of the Rockies. Because these totals have not been published since 1956, they have been estimated subsequently from data reported for all 48 States. Accordingly, the index for all months since 1956 is subject to revision.

¶The index reflects the production of goods that account for about two-thirds of all consumer purchases and is preliminary for the latest month: it is a 3-month moving average plotted at the third month in recognition of the lag in the arrival of goods at retail markets.



sumers' goods, apartment house construction might soon be restricted by structural steel shortages, as stockpiling in this field is relatively difficult; but automobile production is not expected to be affected soon by the strike because of large inventories of automobile manufacturers and the approaching shutdowns for model changeovers.

The index of new consumer goods per capita is expected to increase further during the summer months, but at a perceptibly diminishing rate of increase.

Industrial Production

Production of steel, automobiles, lumber, and electric power (1) in the 1- and 4-week periods ended on the indicated dates in the current year and (2) in the corresponding periods of earlier years was as follows:

	1929	*1932*	*1954*	*1957*	*1958*	*1959*
Steel						
Ingots—million tons						
Week: July 18	1.31	0.24	1.18	2.03	1.49	2.35*p*
Four weeks: July 18	5.22	0.91	4.82	8.20	5.98	9.32*p*
Automobiles						
Vehicles—thousands*						
Week: July 11	113	41	106	144	98	161*p*
Four weeks: July 11	464	200	520	651	373	635*p*
Lumber						
New York Times Index						
Week: July 4	127	38	51	86	98	117
Four weeks: July 4	130	39	87	105	103	115
Electric Power						
Kilowatt-hours—billions						
Week: July 11	1.7	1.3	8.2	12.0	11.8	13.5
Four weeks: July 11	6.7	5.7	34.8	47.5	46.8	53.7

p Preliminary.
* Cars and trucks in the United States and Canada.

DEMAND

Department-Store Sales

Sales of department stores reporting to the Federal Reserve Board compare with those of corresponding periods a year earlier as follows:

Period	*Percent Change*
Week ended July 11	+ 9
Four weeks ended July 11	+11
Year to date	+ 9

BUSINESS

Railroad Freight Ton-Miles vs. Industrial Production

Both industrial production and railroad freight traffic now have regained their prerecession levels. The index of industrial production surpassed its former peak in April and reached successive records in May and June. The index of railroad freight ton-miles reached its prerecession level in May, but it was then still about 5 percent less than the previous postwar peaks reached in 1948, 1951, and 1956. We estimate that railroad freight traffic was somewhat less in June than in May, presumably reflecting a tapering off in shipments of ore and steel products in anticipation of the July 1 steel-strike deadline.

According to the Association of American Railroads, freight carloadings during the first 23 weeks of 1959 (through mid-June) were 10 percent less than those during the similar period of 1957, but nearly 13 percent more than those during the comparable period last year.

Railroad freight shipments are now expected to resume an upward trend after termination of the steel strike. In this connection, concern has been expressed by some shippers and railroad executives that a pronounced resurgence of general business activity following the steel strike may produce a freight-car shortage of serious proportions. Such a shortage last developed during the months following settlement of the 1956 steel strike. Presumably in an effort to avoid or at least lessen the severity of any car shortage later this year most of the major railroads have accelerated their freight-car repair schedules during recent months.

A reduction of railroad freight ton-miles undoubtedly will occur during the steel strike that began July 14. However, a significant increase in railroad freight traffic, perhaps to peak levels, seems probable after the steel mills resume normal operations.

PRICES

Commodities at Wholesale

	1958	*1959*	
Index	*July 15*	*July 8*	*July 15*
Spot-market, 22 commodities	266	267	266
Commodity futures	334	316	315

Note: The indexes are respectively those of the United States Bureau of Labor Statistics and Dow Jones. Both indexes are converted so that their August 1939 daily averages equal 100.

American Institute for Economic Research is a non-political, non-commercial organization engaged in impartial economic research.