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Hazlitt on Gold

by Jude Blanchette

Henry Hazlitt concentrated much of his thinking and writing on the topic of money, producing two books and dozens of articles and columns on the subject. His writings during the dark years following World War II, published on the editorial page of the *New York Times* and in *Newsweek*, offered intelligent readers ammunition against the feverish calls for monetary socialism. His anti-Keynesian columns and articles of the 1960s and '70s provided uncommon knowledge for those who sided against inflation, budget deficits, and the belief that "we owe it to ourselves."[1]

Hazlitt was well known for his views on monetary theory and specifically his advocacy of a gold standard. In its final, polished form, his case for the gold standard was profound and persuasive. What's more, the clarity and precision of his work made the subject accessible to the intelligent public.

Following in the footsteps of the Austrian economist Carl Menger (1840–1921), Hazlitt begins with the origin of money as a commodity. In times of barter, men traded goods directly—two eggs for six apples, for example. It soon became apparent to the more observant traders that there were goods preferred by almost all individuals who traded, and what's more, these highly demanded goods could be used to acquire other goods through indirect exchange. As Hazlitt explained it, "people tried to exchange their goods first for some article that nearly everybody wanted, so that they could exchange this article in turn for the exact things they happened to want."[2] Menger describes this *near* universal demand for a certain good as its "saleableness" (*Absatzfähigkeit*). Because of their numerous advantages over rival commodities, precious metals evolved through the marketplace to become money.[3]

No doubt part of gold's historical appeal as money was its allure. For some who disparage its monetary role, this is indicative of its hold over the imaginations of traders and merchants. Keynes disparagingly called it "*auri sacra fames*" ("the accursed hunger for gold").[4] Hazlitt, however, thought this was one of the attributes that made gold superior to paper money. To be universally desired (and hence to have a high degree of "saleableness"), gold (or whatever commodity came to be used as money) must be held in high esteem; that is, it must be desired by almost all consumers at almost all times. Besides its aesthetic value, gold never spoils and is extremely scarce. As Hazlitt wrote, it could be "hammered or stamped into almost any shape or precisely divided into any desired size or unit of weight."[5] As transactions in gold became omnipresent, traders looked for more efficient ways to exchange goods for gold.

The advent of banks was for Hazlitt another example of the market's supplying

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society with a newer and better way of doing business. Yet Hazlitt also believed that with the appearance of banks, economic booms and busts were born. Banks began simply as depositories for gold. An individual would carry or keep at home enough gold to facilitate daily or small transactions, and would store the rest in a bank vault. When a larger purchase was to be made or when gold for daily purchases was running low, he would return to the bank for more. As Hazlitt wrote, "Then came a development that probably no one had originally foreseen. The people who had left their gold in a [bank] vault found, when they wanted to make a purchase or pay a debt, that they did not have to go to the vaults themselves for their gold. They could simply issue an order to the [banker] to pay over the gold to the person from whom they had purchased something." He continued, "If the receipts were made out by the [bank], for round sums payable to bearer, they were bank notes. If they were orders to pay made out by the legal owners of the gold themselves, for varying specified amounts to be paid to particular persons, they were checks."[6]

The Roots of Fractional-Reserve Banking

It is from this system, however, that fractional-reserve banking evolved, Hazlitt writes. And from this came the devastating economic fluctuations known as the business cycle. Bankers soon began to realize that the amount of gold demanded in its physical form was far less than the amount of gold held in reserve. For the entrepreneurial banker here was a profit opportunity. If loans were made from the present gold stock and this gold stock was rarely touched, why not increase the amount of outstanding credit beyond the bank's reserve capability? Hazlitt notes that "honest" banks would not expand credit beyond what they had in *total* assets, that is, the amount of gold in reserve plus the amount of assets held as collateral for other existing loans. However, because gold deposits must be paid out on demand and assets held as collateral are to be returned at some fixed point in the future, a "bank might be 'solvent' (in the sense that the value of its assets equaled the value of its liabilities) but it would be at least partly 'illiquid.' If all its depositors demanded their gold at once, it could not possibly pay them all."

Thus according to Hazlitt, banks continued to lend funds above the amount of gold held in their vaults. It is here that the "boom" begins. Hazlitt outlines a hypothetical scenario in which banks lower their reserve ratio to 50 percent. With twice the lendable funds, banks are "now suddenly free to extend more credit. They can, in fact, extend twice as much credit as before. Previously, assuming they were lent up, they had to wait until one loan was paid off before they could extend another loan of similar size. Now they can keep extending more loans until the total is twice as great. The new credit plus competition causes them to lower their interest rates. The lower interest rates tempt more firms to borrow, because the lower costs of borrowing make more projects seem profitable than seemed profitable before."[7]

Hazlitt thus found in such credit expansion a cause of the business cycle, which he thought could occur even with "free banking," because banks would be pressured by competition constantly to lower their reserve ratios. While inflation under free banking would be substantially less than under government-managed credit expansion, it would persist nonetheless. Because of his profound dislike of inflation, regardless of the source, Hazlitt favored a "pure" gold standard, or a 100 percent reserve requirement. To secure this, Hazlitt advocated strict government regulation of required reserves. Any expansion of credit above the amount of gold held in reserve was fraudulent, and as such, should be prosecuted by government authorities, he wrote in *The Inflation Crisis, and How to Resolve It*.[8]

Here Hazlitt's position differs from that of his friend Ludwig von Mises, who saw the boom/bust phenomenon as exclusively government-created. While Hazlitt viewed interbank competition as a driving force behind the creation of fiduciary money, for Mises it was exactly *because* banks compete with one another that solvency is assured. Mises conceded that while a slow creation of bank credit would potentially occur under free banking, competitive forces would limit a bank's ability to inflate: "Since the over-issuance of fiduciary media on the part of one bank . . . increases the amount to be paid by the expanding bank's clients to other people, it increases concomitantly the demand for the redemption of its money-substitutes. It thus forces the expanding bank back to a restraint."[9]

Subjective Valuation

Value in currency is not something that can be declared, decreed, or ordered by a government or any private institution, Hazlitt wrote. It is, like the value of all other economic goods, a matter of subjective valuation by market participants. While there is an objective purchasing power for money, it "is derived from the composite of . . . subjective valuations."[10] Economists and government planners who use crude mathematical formulas and rigid exchange relationships between money and prices miss the subjective and thus unquantifiable nature of money's value.

Hazlitt considered all monetary reform specious if it lacked gold redeemability. A monetary system either was sound or it was not. There was no middle ground. He also believed private citizens should be free to mint and circulate private coins for business transactions. Private paper currency would be allowed insofar as it was "redeemable on demand in the respective quantities of the metals specified."[11]

For Hazlitt a gold standard was preferable to any form of government-managed currency because no one controls it. "The supply of gold is governed by nature; it is not, like the supply of paper money, subject merely to the schemes of demagogues or the whims of politicians. Nobody ever thinks he has quite enough money. Once the idea is accepted that money is something whose supply is determined simply by the printing press, it becomes impossible for the politicians in power to resist the constant demands for further inflation."[12] Thus for Hazlitt the gold standard's inflexibility is its great strength. □

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1. Henry Hazlitt, *Man vs. The Welfare State* (New Rochelle, N.Y.: Arlington House, 1969), pp. 10–14.
2. Ibid., p. 154.
3. For an interesting fictional description of this process, see Henry Hazlitt, *Time Will Run Back* (New Rochelle, N.Y.: Arlington House, 1966), pp. 186–212.
4. John Maynard Keynes, *Essays in Persuasion* (New York: Harcourt, Brace and Company, 1932).
5. *Man vs. The Welfare State*, p. 154.
6. Ibid., p. 155.
7. Henry Hazlitt, "Gold Versus Fractional Reserve," *The Freeman*, May 1979, pp. 259–66.
8. Henry Hazlitt, *The Inflation Crisis, and How to Resolve It* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1995 [1997]), pp 187–88.
9. Ludwig von Mises, *Human Action: A Treatise on Economics* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1996), p. 444.
10. *The Inflation Crisis,* p. 89.
11. Ibid., p. 187.
12. *Man vs. The Welfare State*, p. 162.