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Hutt's Views on Money

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W. H. Hutt did not accept Keynesian assumptions of rigid prices. Nor did he concur that the level of demand for money and credit could impact on the role of prices as a co-ordinating mechanism. He did, however, distinguish between real money and money units (nominal money) and what he called 'moneyed demand', the rate of expenditure of money units similar to Keynes's 'effective demand'. Banks were dealers in money who could dilute or condense it, thus impacting on the general price level. Banks sacrifice yield if they are not fully loaned-up, but this does not imply that fractional reserve banking leads to inflation. Absent convertability into a commodity standard, however, that is given government suspension of convertability inflation is then inevitable unless a strict policy of money neutrality is followed by the authorities. The implementation of such a rule is difficult, and while price flexibility would have accomplished the necessary adjustments, Hutt had not progressed towards today's theories of expectations, which might have made his views more tenable at the time of writing.

A PERSONAL INTRODUCTION

It was my own good fortune to be one of W. H. Hutt's students towards the end of his long tenure at the University of Cape Town. Hutt was Professor of Commerce, Dean of the Faculty of Commerce and we studied for the Bachelor of Commerce (B.Comm) degree, which was very much his creation. The degree was described as providing a 'broadly liberal education' for those who intended to follow a career in business. This, to my mind, it certainly did, over three years of full-time study, although there were a number of part-time students, who added some maturity to the proceedings.

Professor Hutt was most actively involved in two of my courses—Commerce Preliminary, in the first year, and Commerce, to which those who had managed the considerable hurdle of the preliminary course, proceeded to take in their second or third years. The subject matter was very much that of applied economics, with a strong emphasis on resolving the economic issues of the day and yesterday, in which Hutt had been very much involved. It was, moreover, a very different kind of economics to that we were exposed to in the formal courses in economics. Costs were opportunity costs, rather than marginal cost schedules. What James Buchanan later described as the subjectivist school of costs was still very much alive and well in those classes (Buchanan, 1969; see also Thirlby, 1946, in Buchanan and Thirlby, 1973). Forward-looking, loss-minimizing rather than profit-maximizing entrepreneurs were the fulcrum of the economic system.

Students were also advised to stay well informed through a close reading of the financial press. *The Economist* was very much recommended reading. I recall vividly that one of the questions in the final examination for the Preliminary Course in 1960 required students to fill in a map of Africa with the latest names of the newly independent countries. I regretted not being able to reply with confidence, because if I had known what I should have known I would surely have obtained good marks. Getting good marks from Hutt was a considerable achievement. You had to get it right, that is, you had to interpret Hutt's own positions on a variety of topics to his satisfaction. We were regaled on numerous occasions with the success that the young Basil Yamey had in doing just that, in no more than a page and a half per answer, as Hutt proudly told us.

Many of us will agree today that Hutt was mostly right when the economics profession had moved wrongly away from the firm ground upon which he stood, grounds prepared for him by his teachers in London, especially Edwin Cannan. As I will show, his views on money were much to the mark. However, Hutt in the spoken or written word was not, I believe it would be fair to say, easy to follow, and one had to work very hard at it, as I have had to work hard on his monetary theory for the purposes of this paper.

These difficulties in exposition were Hutt's weakness but not a criticism that Hutt would have found easy to accept. He, as we know, laboured long and hard to make himself what he thought was absolutely and unambiguously clear: '. . . Clarity of exposition has alone dictated the terminology I employ' (Hutt, 1952a, p. 55). He also found it impossible to avoid developing an independent terminology to suit his analytical purposes, although he expressed a strong dislike for mere 'terminological innovation' (quoting, of all people, R. F. Kahn) unless, as Hutt put it, it assists our understanding of causation. However, he went on to say:

> But I feel that much of the monetary theory which has developed in recent decades has consisted of

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elaborate manipulations of *inappropriate* [Hutt's emphasis] concepts. That is why I thought it necessary to redefine some familiar terms. In so doing, I have made use of originally defined concepts and reasoning, which I introduced for criticism in earlier contributions. No material criticism having been received, I am encouraged to continue with my attempted reintroduction to the theory of money (Hutt, 1953a, p. 215).

Most economists of his own generation were following Keynes and his terminological innovations. They regrettably did not, as we know, make the effort to engage with Hutt. Hutt was largely ignored, but this did not dissuade him from his task. He assumed simply that his challenge to his contemporaries could not be met, and he continued to issue his challenges (see below) in the attempt to bring the economic profession, for which he had so much ambition, back to its classical roots.

However, while Hutt for long was ignored by his peers he had his students, and fortunately we had to take him very seriously indeed. For myself, the formidable Professor Hutt was always interesting and involved, and he inspired me to study and understand the economic world around us. His passion for the coordinating role prices and markets could play was infectious. He made me believe that the world could be made a much better place if economic policies were designed to reinforce rather than inhibit price flexibility. As his plan for reconstruction (Hutt, 1943) makes abundantly (perhaps even embarrassingly) clear, his approach was highly interventionist in favour of market forces. Economists, properly trained, were to be the missionaries for the architects of reconstruction. Hutt's views were, therefore, highly congenial to my own nonconformist and activist mind.

HUTT'S THEORY OF MONEY: SOME PRELIMINARY OBSERVATIONS

Many of the characteristic features of Hutt's work, his sound intuition, his confident grounding in the traditions of the subject, his crusading zeal as well as his expository weaknesses are revealed in his work on monetary theory. The papers that will particularly concern us here were written for the *South African Journal of Economics* between 1952 and 1953:

The nature of money. *South African Journal of Economics* **20**, March, 1952 (Hutt, 1952a): The notion of the volume of money. *South African Journal of Economics* **20**, September, 1952 (Hutt, 1952b): The notion of money of constant value, part I. *South African Journal of Economics* **21**, September, 1953 (Hutt, 1953a): The notion of money of constant value, part II. *South African Journal of Economics* **21**, No. 53, December, 1953 (Hutt, 1953b).

Hutt also contributed 'The yield for money held', perhaps his most influential paper in the field, to the von Mises Veldschrift, edited by Mary Sennhoz in 1956 (Sennhoz, 1956).[1] This paper is by far the most readable of the series and provides a clear summary of the views developed in the earlier papers, explaining why money is not barren, as the classical economists were inclined to think, and the rationality of the demand for real money as a productive resource:

... Money assets offer prospective yields just as the rest of the assets possessed by individuals, firms, banks or governments. As objects of investment, they are chosen for the same reason that other objects are chosen. Thus, if their marginal prospective yield at any time is *below* that of other assets, it will pay to part with some of them, and if it is *above*, it will pay to acquire money assets up to the point at which the marginal prospective yield has fallen to the rate of interest (Hutt, 1956, p. 197).

This is clearly an analysis with which contemporary monetary theorists would find very much to the point. The question will be asked as to how much credit Hutt should be given for his originality in his analysis of monetary theory. This is not a question that is easy to answer. There is no doubt that Hutt came to his position on money largely independently of contemporary writing. By his own admission, Hutt was not well read in the contemporary Keynesian literature (see below). At the time, Hutt could have found support for his views on money from the work of William Baumol and James Tobin on the inventory and portfolio approaches to money (Baumol, 1952; Tobin, 1956). He would also have found the work by Don Patinkin, on 'Price flexibility and full employment', highly congenial (Patinkin, 1948). It was this work that was probably decisive in getting economists to regard Keynes's theory as anything but a general one, as Hutt was so valiantly trying to make them do. I recall that Hutt mentioned in class in the early 1960s that Patinkin was an important Keynesian economist who was unable to avoid the logic of price flexibility. Patinkin receives a favourable mention as to 'one of the few economists who have perceived that the concept of the *real value of money assets* is useful and used to notion explicitly' (Hutt, 1963, p. 106). Hutt's exposition of the links between what we would call today, after Patinkin, the money and the goods markets could indeed be incorporated very easily into a formal general equilibrium framework of the kind Patinkin was developing (see Patinkin, 1948).

Hutt himself would typically not claim originality but would seek to place his own writing firmly within the older, better tradition, from which modern economists had strayed so badly. He regarded himself as restating and clarifying and building upon what was largely known by his own teachers, especially Cannan. The other economist, clearly influential for his thoughts on money, was Wicksell, with his notions of neutral money. He did, however, suggest that the classical doctrine of the sterility of money was previously challenged only by one author, Greidanus (1932), but Hutt argued that Greidanus himself did not see the full significance of his yield theory (Hutt, 1956, p. 196). In this instance Hutt was critical of the classical economists in their regard for money as some barren asset.

Hutt's return to monetary theory was undertaken in 1952 with typical purposes, but somewhat apologetically. In his introductory remarks he referred to his preface to *The Theory of Idle Resources* (Hutt, 1939):

> '. . . after many wanderings, I could not feel that I had found my bearings with sufficient accuracy to guide others'. On the outbreak of the war I temporarily abandoned my explorations in this field. Other things seemed to me to be more important. For one thing, I confidently expected others to point the way for which I had been searching. But after the war was over, I began to think that we were being led seriously astray. In 1946, I felt that I ought to make a modest effort to point the way myself. On trying to do so, however, I found myself confronted with formidable exposition difficulties. I found also an enormous new and difficult literature, in which it was far from easy to distinguish the worth-while from the valueless without much wasted effort. The publication of the collection of the essays in *The New Economics* to some extent solved this last problem whilst strengthening my urge to write on the subject. For this book forms a highly convenient, select and authoritative text for specific criticisms of Keynesianism in its contemporary version. I propose to use it as such . . . (Hutt, 1952a, pp. 50–51).

In typical manner Hutt went on to assert that:

> In my present judgement, an enormous amount of contemporary discussion of monetary theory consists of elaborate analyses based upon essentially invalid concepts. If critics do not refute the main ideas which I am now putting forward (in this and the projected articles), I shall feel that I am in a position to return to the thesis that the so-called 'Keynesian revolution' has been a mere aberration in the history of economic thought. To assist criticism, I have tried to write in a form in which it will be easy to say, in published or unpublished communications, 'Here your argument is at fault', or 'Here your exposition could be clarified or simplified'. It may well be that an even simpler or more succinct statement of my position will occur to the reader. (Hutt, 1952a, p. 51).

In accordance with Hutt's invitation I will offer my own summary of Hutt's views on monetary theory and also attempt to give something of the flavour of the original.

A SUMMARY VIEW

Hutt's intentions were clear enough. This was to show that the existence of money and credit would not inhibit 'the co-ordinating and synchronizing function of prices in determining the rates of flow of co-operant and competing productive services' (Hutt, 1952a, p. 52) and why the Keynesian assumption of price rigidities, which Hutt regarded as essential for generating the Keynesian results, did not follow from economic actors exercising their preferences for real money holdings. The essential distinction Hutt made was between the demand for real money (money in the strict sense as Hutt defined it) and nominal money, or 'money units'. Hutt emphasized the failure of monetary theory to distinguish between the demand and supply of money units and real money. It was the 'abstract' nature of real money that Hutt thought caused the difficulty in properly recognizing the function and role of money. Hutt emphasized the real forces acting upon the real demand for money. It was real money that was productive and the demands for real money were explained, as determined by real forces of productivity and supply:

> Whilst the number of money units is determined through the operation of the credit system (under conditions laid down by the discretion of a monetary authority, or the terms of a convertibility contract), the amount of money in the strict sense is (given any institutional set-up and given 'neutral expectations') created by the productive system (Hutt, 1952b, p. 233).

Real money is obtained in exchange for real goods and services ('for valuable non-money'). Hutt explained that increases in the supply of real goods and services leads to increases in the real demand for money; 'The money unit value of the flow of productive services which may be called "money income", is affected by the number of units of money, the flow of productive services, and the velocity of circulation remaining the same' (Hutt, 1952a, p. 52). Hutt regarded attempts to isolate the functions of money, 'attempts to isolate the factors influencing the shape of the demand and supply curves for those of these things that are popularly called "money"' (Hutt, 1952a, p. 57) as misguided. He regarded a wide variety of assets as offering some degree of moneyness, that is, they were, to a degree, substitutes for money or represented different kinds of 'containers' which held money mixed with something else. Hutt did not think the term 'money substitute' was particularly helpful, preferring 'impure money units' (see Hutt, 1952a, p. 58). His attempts to isolate pure and impure money may be regarded as unsatisfactory, but what is impressive is his understanding of the influence money substitutes would have on the demand for real money:

> Whilst an increase in the number of units and an increase in their velocity will have the same effects upon the scale of prices, I shall later show that *ceteris paribus* a change in velocity affects the amount of *money in the strict sense*, whilst a change in the number of money units does not. And one of the factors which may influence velocity is anticipation of changes in the content of money units. That

is why, in the heading of this section, and in three paragraphs above, I have qualified the assertion that the amount of money in the strict sense is created by the productive system, by the words 'and given "neutral expectations"' (Hutt, 1952b, p. 235).

Hutt clearly saw the links between changes in the demand for real money and its impact on demand for and supply of goods and services and, therefore, on prices. Changes in the demands for real money might 'dilute' or 'condense' the real supply of money through its effects on prices generally:

> I have pointed out that, as *individuals*, in order to demand money assets, we must offer newly produced or old products in exchange for such assets. Indeed, as individuals, we can if we wish, exchange nearly all our assets for money. But *as a community* it is obvious that we cannot do this. As a community, we can only hold more money in the strict sense, i.e. more money assets measured in *abstract unit of constant barter power*, than we have been holding if, in fact, we exercise the rights contained in actual money units more slowly (on the assumption, of course, that the flow of productive services does not increase). But if we do spend more slowly, then we increase the amount of money in the strict sense. *The decline in velocity will increase the total value of assets (other than capital consumers' goods) which are held by the community for the monetary services which they can render.* In other words, society will own assets of greater value and quantity in the form of 'pure money assets', or in the 'pure money assets' equivalent of 'impure money assets'. This additional money is not, of course, created out of thin air. It is produced through a special use of the community's scarce resources, and at a cost, namely, the 'sacrifice' of prospective pecuniary returns, from other instrumental capital, and the 'sacrifice' of non-pecuniary gratifications from other consumers' capital goods (Hutt, 1952b, p. 239).

Hutt was well aware of the advantages of a developed money and credit system. The availability of credit, especially bank credit (what Hutt called 'credit money'), was especially important if entrepreneurs were to exercise their imagination. Banks did not, according to Hutt, manufacture or create money in ways that would necessarily undermine stability. They were 'intermediaries', 'dealers in money, not makers of it' (Hutt, 1952b, p. 234), although the actions of banks could influence the demand for money and therefore prices. Banks, therefore, could 'dilute' real money or 'condense' it by causing prices in general to rise or fall. The attainable objective of monetary policy was to neutralize the influence of the credit markets on the demand for money.

The central bank, too, is regarded by Hutt as also supplying credit money and hopefully in a way that would make money neutral: 'In short, the effect of neutral system is to make the Say Law as true in terms of moneyed demand as it is in terms of real demand' (Hutt, 1953b, p. 351). Hutt preferred 'moneyed demand' to Keynes's 'effective demand' as representing the rate of expenditure of 'money units' (Hutt, 1953b, p. 343). Hutt's money units were what would be defined as nominal money.

Hutt thought that, ideally, the monetary system should generate stability of prices in general. He did not, as indicated previously, regard banks as a threat to such stability, criticizing, among others, D. H. Robertson for blaming the banks for, as Hutt quoted Robertson, 'the tremendous orgy of money creation after World War I'. Hutt defended the banks, saying that their responsibility to depositors was in terms of the legal tender and, to quote Hutt, 'the responsibility for the dilution of those units was solely that of the government, where it suspended convertability without having resort to any other sufficiently effective means of limiting the number of money units' (Hutt, 1952b, p. 236). Hutt was of the view that if the banks were required to maintain convertability into a commodity money then there would be no danger of overissuing of credit by the banking system. Furthermore, banks could be required to supply sufficient credit for the purpose:

> . . . for if the 'dealers in money' (i.e. the monetary authority itself, or the banks) do not so expand credit, they sacrifice a prospective yield; and if they do not so expand credit, they accept a prospective loss. Such would be the pressures to socially wise monetary management under a system of neutral money (Hutt, 1952b, p. 237).

Hutt was much concerned about the problems of shifts out of goods into money or vice versa, hoarding or dishoarding, and the responses the monetary authorities should make, given less than perfect price flexibility. He did not, however, regard controls over the supply of money as having powers to stimulate the economy:

> . . . I should explain my failure to suggest, as so many writers have done, that money has some function or power to 'promote' or 'stimulate' 'economic life', or production, or the 'development' of the economic system. This, I shall maintain, it cannot do, except in the sense that any efficient technical mechanism plays its part in the productive process, e.g., the transport system. I shall contend that, whilst the multiplication of money units may be used as an alternative to the co-ordination of prices, i.e. as a means of releasing 'withheld capacity', this can be achieved only in a relative crude way, and at the expense of a permanent decline in the barter power of money units.
>
> It is my conclusion that in no other way can money be said to 'lubricate' or 'stimulate' the economic system; whereas failure to realize this truth has prevented sufficient attention being devoted to the problem of 'stimulating' the economic system through the achievement of synchronization in the process of production and consumption by means of price adjustment (Hutt, 1952a, pp. 56–7).

Hutt might have argued that any attempts to stimulate the economy in this way, as an alternative to appropriate adjustments of prices, would have been anticipated and incorporated into the inappropriate set of prices. In other words, Hutt's work would have benefited greatly from a theory of expectations; ideally, consistent or rational expectations. Hutt's discussion of the impact of hoarding or dishoarding, that is, of changes in demands for real money, painstakingly covers all possibilities, with and without price flexibility and with and without what is defined as monetary rigidity, that is, given the failure of the monetary authorities to maintain monetary neutrality.

Maintaining Hutt's monetary neutrality would, however, be no simple task for the authorities. These would do best, according to Hutt, to ignore short-term effects which would be reversed. The authorities should set themselves the task of maintaining the long-term purchasing power of money, that is, what the value of money would be under 'correct expectations'. Hutt suggests that:

> ... faith in the intentions or the ability of the monetary authority would prevent either kind of speculative action. [i.e. destabilizing speculation]. That, I believe, might very well be the actual consequence if a neutral policy were earnestly pursued in practice. But contemporary monetary discussions often leave the impression that monetary authorities must be more or less helpless when expectations about their intentions differ from their actual intentions. Hence, there are problems which have to be considered (Hutt, 1953b, pp. 348–9).

This is, of course, not quite to say that the monetary authorities would do best by following some kind of monetary rule to make their actions entirely predictable and so help avoid incorrect expectations. Hutt clearly did not extend his faith in the rational loss-minimizing behaviour of entrepreneurs and others to the formation of expectations. Price flexibility, of course, would quickly resolve the problems caused by incorrect expectations.

CONCLUSION

Hutt clearly had very good grounds for resisting Keynesian monetary theory. His sense of the stability of the monetary system was appropriate. He was right to regard the Keynesians as taking economics away from its traditions and the truth. Economists would have done well to have given Hutt much more attention than they appeared to do.

Hutt expended enormous effort in the attempt to help the economics profession to avoid the Keynesian aberration, for which he deserves great credit and respect. Why Hutt was not more influential remains an important question, not easily answered. Certainly, his relative isolation in South Africa hampered his efforts. He remained very much the academic, who resisted giving advice that was politically convenient. Therefore, very unlike Keynes, he did not much influence economic policy, even South African economic policy, in which he took a great interest. He also, it should be said, had his own idiosyncracies of style. Hutt's style was and remained an older one. This is not to gainsay the virtues of a more literary approach. If one's ambition (and it was Hutt's ambition) is to change the way people think it is advisable to accept their language. The use of mathematical symbols and perhaps also some simple mathematics, after the fashion of the younger writers in the monetary field like Patinkin or Baumol, would certainly have helped to attract the audience Hutt deserved.

NOTES

1. The discussions of monetary theory and policy in his later works (Hutt, 1963, 1979) did not take the theoretical arguments any further.

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