

Mindmap of part of  
Chapter 2 of ***The Failure  
of the "New  
Economics"*** (1959) by  
Henry Hazlitt. Available at  
[https://mises.org/library/  
failure-new-economics-0](https://mises.org/library/failure-new-economics-0)

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Keynes wants to disprove that the most frequent cause of unemployment is excessive wage rates

Hazlitt points out that in "classical" economics this is similar to the idea that the reason commodities go unsold is because the seller won't accept a price that will clear the market: **If the proposition is not true with regard to labor, it is not true with regard to commodities either. Both propositions rest upon the same line of reasoning. Both are special cases of a wider proposition covering both commodities and services.**

Keynes starts off by saying that "labor" will resist reductions in money-wages but not in real wages.

Justin's Comment: I understand "money-wages" to be referring to the idea of "nominal wages". I am more familiar with the nominal wages terminology.

Justin's Comment: This may be partially laying the groundwork for the theory (which I associate with Keynesianism) that some inflation is fine because wages (or money-wages in Keynes' terminology) are "sticky" but people will put up with some regular reduction in real wages without complaint. Thus, the theory goes, inflation allows us to give people pay cuts when they are needed without arousing popular resentment.

First Hazlitt criticism (factual point): Hazlitt brings up the point that unions have economists and researchers who are aware of things like the consumer price index. He gives concrete examples of workers who had cost-of-living adjustments in their contracts in the 1950s.

Second Hazlitt criticism: Keynes' ideas regarding money-wages and real-wages don't actually address the "classical" idea: **The classical contention is that if wage-rates (whether considered in terms of money wage-rates or real wage-rates) are above the level of the marginal productivity of labor, there will be unemployment.**

Justin's Comment: Hazlitt's claim here seems very plausible!

Justin's Comment: I was right 😊  
Hazlitt: **Why is Keynes so concerned to make this point about "labor's" attitude toward money wage-rates and real wage-rates respectively? The collectivist word "labor" implies that we need not think in terms of what individual workers would wish or do, but only in terms of what union monopolists wish or do. He is concerned because he will be later eager to prove that while it is "impossible" to persuade unions to accept a cut in money wage-rates, it will be easy to deceive them into accepting a cut in real wage-rates by the simple process of monetary inflation—erosion of the purchasing power of the monetary unit.**

Justin's Elaboration: Suppose a turkey pot pie bakery pays a worker \$50/week and this worker enables the bakery to make and sell 6 more pies a week. 🍗 Suppose turkey pot pies cost \$10. You can perform an economic analysis of the determination of the rate of unemployment under classical theory in terms of either the nominal/money wages or in terms of the real wages expressed in goods. some\_wage\_rate could be expressed in terms of \$50 a week or 5 turkey pot pies a week (or any other goods), it doesn't really matter.

Further Elaboration: Suppose Bernie Sanders says "It's not fair that a baker slave and sweat all day and she can't even get one pie a day for herself and her family. As President, I will propose raising the minimum wage for pie baking to X." And X is some figure expressed *either* in dollars or in terms of some goods. If X is a figure higher than the worker's actual marginal productivity, then Bernie Sanders' proposed legislation will cause unemployment, regardless of whether you express X in terms of money-wages or real wages. E.g. if Sanders wants to raise the minimum wage to \$70 a week, or to "enough money to buy a pie a day", which would be 7 pies times \$10 = \$70, the unemployment caused would be identical under the classical theory.

Hazlitt criticism: this is a mere assertion.

Hazlitt second criticism: Keynes overstates case here. Hazlitt: ...I **do not know of any serious economist who maintained or maintains that the initiating cause of the 1929 crisis was excessive wage-rates.** What responsible economists did and do assert is that once the crisis had developed, and demand and prices had collapsed, it was necessary for wage-rates to adjust themselves to the reduced level of demand and of prices if mass unemployment was to be averted. It was the failure of this wage adjustment to occur that led to prolonged mass unemployment for ten years.

Justin's Comment: I have no reason to doubt Hazlitt's statement as to what the opinions of professional economists were.

Hazlitt mentions that money and real wages went up from 1931 to 1939 thanks to government intervention, and that in that period: **there was an average annual unemployment of 10 million men and women.**

Keynes: **the contention that the unemployment which characterizes a depression is due to a refusal by labor to accept a reduction of money-wages is not clearly supported by the facts. It is not very plausible to assert that unemployment in the United States in 1932 was due either to labor obstinately refusing to accept a reduction of money-wages or to its obstinately demanding a real wage beyond what the productivity of the economic machine was capable of furnishing**

Keynes elaborates: **Wide variations are experienced in the volume of employment without any apparent change either in the minimum real demands of labor or in its productivity. Labor is not more truculent in the depression than in the boom—far from it. Nor is its physical productivity less. These facts from experience are a *prima facie* ground for questioning the adequacy of the classical analysis.**

Justin's Summary: Keynes is saying that the amount of employment changes without labor changing its demands or without its physical productivity changing. He claims these alleged facts should call into question classical theory.

Hazlitt's criticism: **Keynes has here tumbled into a glaring fallacy. The absence of change in *physical* productivity is completely irrelevant to *money* wage-rates. What counts in economics is only *value* productivity—and value productivity stated in this case, of course, in *monetary* terms. If the marginal productivity of a worker is a given unit of a commodity that previously sold for \$10, and the price of that unit has now fallen to \$5, then the marginal value productivity of that worker, even though he is turning out the same number of units, has fallen by half. If we assume that this fall in prices has been general, and that this represents the average fall, then the worker who insists on retaining his old money wage-rate is in effect insisting on a 100 per cent increase in his real wage-rate.**

Justin's Comment: really well put and clear explanation from Hazlitt here! Keynes is looking at the economy kinda statically. He's not thinking about how changes in the world and in consumer preference can affect the value of labor in various lines of production. He's just looking at some workers and saying "well they didn't demand more money or start producing less, so the problem can't be that wages are too high." Whereas Hazlitt points out that the physical workers of the productivity could be identical (making same number of turkey pot pies a week or whatever) but if people value the thing being produced less, then merely keeping the wage the same can basically be asking for a big raise. Fantastic point!

Hazlitt elaborates: **Whether the worker is "truculent" or not is entirely beside the point. If prices fall by 50 per cent, and unions will accept a wage cut, but of no more than 25 per cent, then the unions are in effect demanding an increase in real wage-rates of 50 per cent. The only way they can get it, and retain full employment, is by an increase of 50 per cent in their physical (or "real" value) marginal productivity to make up for the drop in the price of the individual unit of the commodity they help to produce.**

Hazlitt: **It is instructive to notice that Keynes never challenges this proposition head-on, or by any coherent and clear-cut argument. He attacks it rather by a series of oblique sallies, in which the argument is usually involved and obscure and often clearly fallacious.**

Justin's Comment: So we should expect the relationship between what Keynes is arguing and the "classical" theory of unemployment to sometimes seem vague if Hazlitt is correct in his characterization of Keynes' arguments.

Keynes: **When money-wages are rising . . . it will be found that real wages are falling; and when money-wages are falling, real wages are rising"**

Hazlitt concedes that "when money-wages are falling, real wages are rising" is historically true.

Hazlitt shows some tables for times this held true.

Justin's Question: Is this just an empirical fact, or is some fundamental economic principle involved here?

Hazlitt disputes "When money-wages are rising . . . it will be found that real wages are falling."

He cites data showing that the consumer price index (which he is using to indicate money wages) rose from 1939 to 1957, but weekly manufacturing wages rose faster.