Hawtrey and Robertson: A Comparison of Their Views on Monetary Factors in the Business Cycle

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The ideas set forth by economists Ralph Hawtrey and Dennis Robertson have had a major impact on monetary thought since their works were first published many decades ago. Their mere presence in academic discussions today is a testament to the legacy and power of the concepts they were a part of developing. Although they were contemporaries, and were both associated with the Cambridge School of thought, their famous works present largely opposing viewpoints concerning the role of monetary factors in the business cycle.

The models Hawtrey developed in his numerous writings contend that cycles are purely monetary in nature and that monetary policy can be used to counteract booms and depressions. Robertson took a largely different approach. In his early works he viewed the cycle as arising from real factors, and noted that fluctuations were largely a necessary by-product of growth. In fact, in his *A Study of Industrial Fluctuation* (1915) "money makes no appearance until page 211 out of a book of 254 pages". (Goodhart 29) Robertson was also of the belief that monetary expansion or contraction could not eliminate the cycle, and "any attempt to remedy for undesirable fluctuations by such means may well be more damaging than the disease". (Bridel 80) It wasn't until later publications, notably *Money* (1922) and *Banking Policy and the Price Level* (1926), that monetary factors were introduced. Even then, they were seen to only complicate fluctuations, not cause them. "This conception of the role of money is the very antithesis of Hawtrey' s purely monetary theory of the cycle." (Bridel 80)

The goal of this paper is to examine the parallels and differences present in the beliefs Hawtrey and Robertson held regarding the origins of, and policies to counteract the business cycle. The models developed by each will be presented. Differing viewpoints will be readily evident and comparisons will be made where they can.

Ralph Hawtrey

No one would accuse Ralph Hawtrey of suffering from writer's block. He was published prolifically prior to and after the Great War. A list of his major books dealing with the business cycle includes *Good and Bad Trade* (1913), *Currency and Credit* (1919), and *Trade and Credit* (1928). His works are based on the foundation that monetary factors cause economic fluctuations.

The core of Hawtrey' s argument is that credit is inherently unstable. He believed that credit "left to its own devices, tend[ed] to fluctuate widely, carrying the rest of the economy with it". (Mehrling 74)

> "The real starting-point of the whole [argument] is to be found in the thesis. . . that a depression of trade is in essence a general slackening of the money demand for commodities, and an expansion of trade is a general augmentation of the money demand for commodities." (Hawtrey 1913, p. 272)

If the demand of merchants was to increase, because a wedge has been driven between expected profits and the market rate of interest, Hawtrey believed that firms would increase their inventories and that (sticky) prices in the immediate short-run would remain constant - "changes in the rate of interest such as we are considering are too small to affect retail prices immediately". (Hawtrey 1913, p. 62) These inventories would grow with the aid of bank loans. These increased loans must be offset on the balance sheet by new deposits, which would swell the economy's 'unspent margin' (essentially the difference between income and expenditures) beyond desired levels. This in turn induces increased expenditure, which again increases the demand for bank loans to further grow inventories.

It is easy to see how this growth (or the reverse) could perpetuate itself. However, as Laidler (1993) points out, the presence of currency limits this problem. Increased expenditures drain currency from banks, which in time will cause banks to increase the interest rate sufficiently until the natural rate is in line with the market rate of interest and money supply is in line with production. However, time lags are involved that

do not make this a precise science:

> "It is only after a considerable interval that the prosperity of the manufacturer is reflected in an increase of wages. Consequently it is only very gradually that the bankers can become aware that the growth of credits is threatening their reserves of coin." (Hawtrey 23)

This will also cause banks to 'overshoot' (as production will begin to fall before wages do) and instead of a new equilibrium being reached at higher income levels, the market rate will now exceed the natural rate and firms will lower production. Equilibrium is not reached; the economy is in a constant flux.

What stabilisation policies does this economy require? Hawtrey most definitely did not believe that direct government intervention (fiscal policy) would be effective. (Bridel 75) He was a proponent (and author) of the 'Treasury View', which stated that,

> "The. . . principle that the government should add to the effective demand for labour at the time when effective demand of private tenders falls off. . . overlook[s] the fact that the Government by the very fact of borrowing for his expenditure is withdrawing from the investment market savings which would otherwise be applied to the creation of capital." (Hawtrey 1913, p. 260)

Essentially, government spending would crowd out private investment. Robertson, for one, vehemently opposed this view, stating that it "scarcely deserves formal refutation". (Robertson 1915, p. 253) Hawtrey believed that the banking system has the ability to stabilise merely by effective use of its lending rate to control the booms and recessions. Laidler prescribes a strong central bank with large reserves and a cautious attitude. (Laidler 1075)

A final point concerns what is now described as a 'credit deadlock'. In this circumstance, no matter how much the bank lowers its lending rate, firms still believe that their rate of profit will be below this market interest rate. In this situation no interest rate will induce borrowing by firms. Banking policies will be wholly ineffective. Hawtrey was sure to note that this was an extreme case that was unlikely to be seen in the real world. (Bridel 74) Robertson foresaw a similar situation in stating that "while there is always *some* rate of money interest which will check on an eager borrower, there may be *no* rate of money interest in excess of zero which will stimulate an unwilling one". (Robertson 1926, p. 81)

Dennis Robertson

The ideas developed by Dennis Robertson can essentially be divided in two - those presented in *A Study of Industrial Fluctuation* (1915) and those developed later, notably in *Banking Policy and the Price Level* (1926). Throughout his works he maintains the belief that crises are caused by over investment, and that the factors leading to this are *not* monetary in nature.

His *Study* was a large undertaking that attempted to explain, theoretically and empirically, the causes of the trade cycle. Explanations were not uncommon at the time. As Robertson notes:

> "The causes of crises and depressions alleged before the various committees of Congress in the eighties amounted to some 180 in number, and included the issue of free railway passes and the withholding of the franchise from women." (Robertson 1915, p. 1)

Robertson believed that growth was fuelled mainly by significant technical innovation. If an economy jump-started as a result of innovation, "there would be an upsurge in the demand for constructional, investment goods". (Goodhart 25) The length of this upsurge depended greatly on the gestation period of the new investments. Robertson believed that this lead to over investment, because firms would be ignorant of others' plans, and because of a race to profit bytrying to get new equipment ready as soon as possible.

Eventually, inefficiencies and rising costs will return. This, in addition to problems of under-saving and the distribution of some wealth to the

rich during booms as described by Robertson, would help to begin the downturn. (Goodhart 26) Instigating all of this though, believed Robertson, was over-investment.

Why does output begin to fall? The opportunities facing producers have contracted, and individuals will choose to shift some of their time away from (the now less productive) work to leisure pursuits. The reduction in output is a supply-side phenomenon. (Goodhart 27)

These fluctuations in output must be viewed then as a necessary component of growth. Innovation is not predictable, and brings with it unexpected booms which will be followed be times of over-investment. Robertson would term variations in output caused for this reason as 'appropriate' fluctuations. Price stabilisation and monetary control were not always the correct policies to pursue. "Monetary control could not be regarded as a 'panacea' but as merely 'one ingredient in a much more arduous and comprehensive programme' . . . [of] 'Stabilisation'." (Fletcher 258)

Using the ideas developed in the *Study,* Robertson integrated monetary factors into the analysis in *Banking Policy and the Price Level* and expanded upon the policy roles that banks and the government should undertake. He examined why actual fluctuations in output would tend to exceed those he termed appropriate. It was believed that these remaining (or 'inappropriate') factors were psychological influences (the herd instinct) and monetary influences. Monetary influences acted not to *cause* fluctuations, but to exacerbate them.

Robertson introduced a forced saving model (which he called imposed or involuntary lacking) to explained monetary influences. For example, a rise in the efficiency of investment (e.g. from an innovation) not immediately matched by a rise in the market interest rate will lead to a rise in total expenditure. Before output can respond, prices will rise (notice that this is the opposite of the mechanism that Hawtrey described) and forced saving will occur because people involuntarily lower their consumption. Wages would soon be pushed up and prices would rise again. This process could be ended by the banking system restricting the supply of new money, but even if not, after the gestation period, there would naturally be a decline in the marginal efficiency of investment. (Wilson 44-45)

Robertson made sure to note that monetary policy should not seek to stabilise the price level as a means of stabilising output. As Robertson notes,

> "a monetary policy designed to restore [the economy] to its original figure is neither the most natural response of the monetary system, nor the most effective in interpreting the underlying situation and establishing the results for which it calls". (Robertson 1926, p. 34)

Because appropriate fluctuations will occur, the aim of monetary policy should be to help foster these appropriate fluctuations and prevent inappropriate fluctuations. (Fletcher 261) Robertson also recommended the use of government policy, including public works expenditures and the accumulation of buffer stocks by the government.

Conclusions

The differences in the ideas developed by Hawtrey and Robertson are readily apparent. Hawtrey viewed industrial fluctuation as arising from purely monetary factors, while Robertson saw monetary factors as only adding to fluctuations that were caused by real factors. Hawtrey's mechanism relied on the notion that output must adjust prior to prices. The concepts presented above highlight these, among other differences.

Similarities exist, but not in any grand sense. Like all others in the Cambridge School, both economists recognised the role that sticky wages play in the analysis. Both recognised the role of banks as the device through which money enters the market, and as an important inhibitor (or promoter) of fluctuations. However, Hawtrey and Robertson adapted these notions for their specific models. Although some of the ingredients are the same, the finished products appear quite different.

The analysis developed by Hawtrey and Robertson concerning the roles of monetary factors in the business cycle have had a lasting effect on economic thought. Although quite dissimilar in their approaches, economists have recognised the profundity of each approach, and continue to build on these foundations today.

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