Missing the Mark: Salsman's Review of the Great Depression

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Objectivist Richard M. Salsman has recently published a long, four-part essay on the Great Depression (2004a; 2004b; 2004c; 2005). The purpose of the essay appears to be three-fold. First, Salsman wants to disabuse the reader of any belief in the conventional Great Depression "fable"[1]: the assertion that laissez-faire capitalism caused the depression and that government intervention brought it to an end. Second, he wants to convince the reader that businessmen are all heroic and productive persons who, furthermore, are rarely if ever deceived by central bank manipulations of money, credit, and interest rates. Third, Salsman wishes to instill in the reader nothing less than contempt for those economists whose business cycle theories rely upon concepts such as "malinvestment," "speculative bubbles," "overpriced stocks," "over-production," or "inadequate demand." In effect, Salsman condemns virtually all economists as being deeply misguided and anti-business: Marxists, Keynesians, Progressives, Institutionalists, monetarists, *even Austrians*. This last constitutes a major departure from past orthodox Objectivist[2] doctrine, since Ayn Rand (1967, 339–40) herself praised the economic theories—though not necessarily the philosophical stance—of Austrians such as Ludwig von Mises and Henry Hazlitt. Obviously, though he never states this explicitly, Salsman must think that Rand was gravely in error to have had high regard for Austrian economists.

The present paper takes Salsman's essay to be significant and thus deserving of attention. Therefore, it will carefully examine the evidence he presents. There is an abundance of data, some provoca-

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tive observations, and, of course, his contentious conclusions. A review of the essay's principal points will be given first. As closely as possible, this will follow Salsman's own presentation. Commentary will be kept to the minimum and will be relegated to the Notes.

Then the paper will differentiate those points that are problematic from those that are not. And an assessment will be offered as to the degree to which Salsman ultimately succeeds or fails, as well as an extensive discussion of the source(s) of that success or failure. Finally, there will be some closing comments on the messages embedded in this somewhat bizarre essay.

The Case Against Intervention

Salsman correctly observes that the American economy was expanding and seemed quite prosperous during the 1922–1929 period, while it spiraled downward into a demoralizingly deep depression following the stock market crash in the fall of 1929, which decline was not reversed until the end of World War II. He further states that this expansion and contraction of the economy was the direct result of minimal government interference during the 1920s, coupled with accelerating intervention (which soon reached massive proportions) during the 1929–1945 period. In political terms, the administrations of presidents Harding and Coolidge were conducive to a great increase in American production and wealth.

> Real per capita personal income grew by 38% in the 1920s, while the U.S. population increased by 11%. Life expectancy had grown 8% from 1910 to 1920, but then grew 10% by the end of the 1920s, to 57 years. Fortunes were made and mansions were built in the 1920s. Real wages sky-rocketed, the general standard of living increased and the scope of human comforts widened. The decade also was characterized by benevolence[3] and care-free fun: tap-dancing, vaudeville, the Charleston, "flappers," and the "speak-easy," where Americans openly defied prohibition. The U.S. stock-market rise of the 1920s was just as spectacular as the rise in production—and just as genuine. . . . From the summer of 1921 to the summer of 1929, stock prices of US-traded firms increased 385%—the biggest eight-year rise ever recorded,

before or since. (Salsman 2004a, 20)

In starkest contrast, the administrations of Hoover and Roosevelt (1929–1945) were hostile to business and thus served to cripple the economy. How severe was the decline? Salsman cites many of the commonly recounted measures of that decline:

> [Stock] prices plunged 88% from their peak level in September 1929 through June of 1932. As late as April 1942, US stock prices were still 75% below their 1929 peak. . . . US industrial production peaked in July of 1929 and by the summer of 1932 had plunged to just 46% of the prior peak. . . . From 1929 to 1933, the profits of the largest US firms plunged by 76%. . . . At the worst point, in March of 1933, 28% of working-age Americans had no job. In 1929, prior to the stock-price crash, the unemployment rate had been a mere 5%. . . . During the 1930s, unemployment averaged 17% and never fell below 14%. . . . In late 1929, roughly 25,000 banks operated in the US. By the end of 1933, 40% of these banks had gone bankrupt and closed their doors. (16)

Salsman proceeds to identify many of the concrete governmental actions that so profoundly affected the private sector during this roughly twenty-five year period. In particular, he draws attention to the effects of taxes.[4] After World War I, the highest marginal income tax rate was set at 77%. Harding and Coolidge managed to lower this to 25% by 1925, while the corporate profits tax rate was reduced from 13.5% to 11% (18–19). Presumably, Salsman is here working from the eminently reasonable proposition that a lower tax burden will encourage greater saving by individuals and, thus, will provide a greater pool of funding from which entrepreneurs can finance expanding levels of production. Conversely, higher tax rates discourage saving and investment and therefore decrease production. These reductions in federal tax rates brought about a net decline of 31% in federal tax receipts between 1921 and 1929, but this was accompanied by a 38% fall in federal spending, so a budget surplus was the result (19).

Other economic factors during the 1920s that Salsman sees as "bullish" were monetary in nature. On the one hand, in 1925 the British returned to the gold standard,[5] having abrogated the convertibility of the pound-sterling during World War I. Indeed, several other countries—Canada, Italy, Germany, and France—also returned to gold, albeit in diluted form in some instances (19). On the other hand, the American dollar had remained convertible into gold throughout the "Great War"and through the 1920s. Furthermore, according to Salsman, the American money supply did rise between 1921 and 1929, but "at a rate (29%) that was less than one-third as fast as the growth in money demand—a demand that was reflected in the growth rate of industrial output (109%).[6] It was precisely because *money was not created in excess* that both wholesale and retail prices in the U.S. actually declined in the eight years ending in 1929. Prices declined slowly each year" (21; emphasis added).[7]

This latter description of the path of prices would, no doubt, be characterized by virtually all economists as "gradual price deflation." Yet Salsman rejects such a characterization. He insists that "there was neither inflation nor deflation in the 1920s. The US monetary standard was not debased; the dollar's gold content was not changed in the least" (21). That is, Salsman apparently defines inflation quite narrowly as a decrease in the gold content of the monetary unit, and deflation as an increase in that gold content.

Given that world peace had been restored, that international trade was growing, that American tax rates fell, and that monetary regimes were relatively stable, the economic results were of course very good. Moreover, "[t]he prosperity of the 1920s was both *genuine and sustainable*[8]; it lasted about eight years (1922–1929) and ended only when statist policies were re-imposed" (19).

Those statist policies were undertaken during the administrations of presidents Hoover and Roosevelt, two men who were sworn enemies of free markets. Salsman (2004b, 11) accurately identifies Herbert Hoover as a typical Progressive whose beliefs were infused with the corrupt philosophical notions of Marx, Hegel, Kant, and Dewey. The economic views of the Progressives were organized around the assertion that markets were "coercive, irrational, and unstable" (11). The "greed" of businessmen needed to be curbed, and the mission of government was to redirect the economy toward

the communal good. As president, Hoover's first major assault on capitalism came close on the heels of the stock market crash in late October of 1929. Persuaded by the fallacious proposition that maintaining consumers' purchasing power was vital to economic recovery, Hoover strongly pressured businessmen not to lower wage rates, despite the decline in business profits and the rise in unemployment. Many complied with Hoover's exhortations, and unemployment rose further as a result (17–18).

The second was the Smoot-Hawley Tariff Act, which became law in June of 1930. This allegedly quadrupled the tariff rates[9] on goods imported into the United States, provoked tariff retaliation by thirty nations, and contributed to a 61% decline in world trade between 1930 and 1933 (15). The retaliation by other nations severely restricted the foreign demand for American farm products, accelerated the rate of bankruptcy among farmers, and thus contributed to the rash of bank failures (mostly among small rural banks) that began in 1930. And, according to Salsman (17), instead of removing some of the regulatory burdens under which banks labored, Hoover signed the Glass-Steagall Act of 1932, which forcibly separated commercial banking from investment banking[10] (a commercial bank accepts deposits and makes loans, while an investment bank is not a bank in the usual sense of the term but is instead an institution devoted primarily to the underwriting of corporate issues of stocks and bonds).

Further economic damage was done by the Norris-LaGuardia Act of 1932 (18). This greatly enhanced the power of labor unions by 1) making nonunion pledges by workers unenforceable in federal courts and 2) exempting unions from liability for wrongful acts under existing antitrust statutes. Additional transgressions by Hoover included the Agricultural Marketing Act and the Emergency and Relief Construction Act, as well as the creation of agencies such as the Federal Farm Board, the National Credit Corporation,[11] the Reconstruction Finance Corporation, and the Federal Employment Stabilization Board. "On Hoover's watch, businessmen, farmers, and investors were inundated and ruined by an array of interventionist agencies and acts" (18).[12] Hoover was a left-wing Republican and thus no friend to capitalism. His activist agenda only served to exacerbate America's economic woes.

> Instead of attributing the depression to his own policies, Hoover blamed foreigners—those whose exports to the U.S. had been taxed and blocked by his punitive tariffs. Later, in a last, desperate attempt to exonerate himself and Progressivism, Hoover would regurgitate the usual screed[13] of Marxists (and of Austrian economists such as Mises and Friedrich Hayek): that economic depression is the "inevitable" result of a previously "false" prosperity. (19)

As bad as Hoover had been, worse was yet to come. Franklin Delano Roosevelt took office in March of 1933, at what was probably the lowest point of the Great Depression. In order to cope with the crisis that was at hand, Roosevelt asked for, and was granted, essentially dictatorial powers (Higgs 1987, 167–72, 194). He did not hesitate to use such powers, being an admirer of both Stalin and Mussolini. Within days, Roosevelt had declared a national bank holiday. Soon thereafter, he stated that the nation was now off the gold standard and "ordered the abrogation of gold clauses in government and private bonds; for years, the clauses had protected lenders from inflation" (Salsman 2004c, 15). Citizens who "hoarded" gold, that is, who refused to exchange their gold coin, gold bullion, or gold certificates for the government's paper currency, faced "$10,000 fines and 3-year jail terms" (15).[14]

Having quickly sabotaged the monetary system, Roosevelt and his "Brain Trust" of advisors turned their attention to the producers of real goods. The fundamental proposition that animated their policies toward those producers was the belief that too much had been produced. Their mission was to curb the rate of production—and thereby prop up prices—through various cartelization schemes. For manufacturing, this took the form of the National Industrial Recovery Act (NIRA)[15] of 1933, which was implemented by the National Recovery Administration (Higgs 1987, 177–79). Farmers saw the introduction of the Agricultural Adjustment Act (AAA), also in 1933. Both acts served primarily to stifle market activity and further reduce the prospects for recovery. Fortunately, both the NIRA and the AAA were declared unconstitutional by the U.S. Supreme Court in 1935, but the anti-production bias in public policies remained. "New Dealers did not believe there was insufficient wealth-creation; they

believed there was *too much* wealth already. They did not fear lower output; they said output was excessive and should be curbed" (16; emphasis in original). Such a belief, Salsman emphasizes, is both false and directly contrary to the insights of classical economists who upheld the truth of Say's Law. This famous economic principle "stressed the primacy of production (and hence of producers), showed that supply constitutes demand, argued that saving and investment bring prosperity, rejected the 'over-production' myth, and denied that consumption caused production" (16).[16]

Roosevelt engaged in a multitude of public works projects as part of his Keynesian-type plan to keep wages, and therefore consumer spending, from falling.[17] The funding for these projects amounted to $3.3 billion—or 72% of total federal spending—in 1933 alone (18). To avoid having budget deficits as a result of the increased spending, Roosevelt and Congress raised tax rates. In 1936, the highest marginal income tax rate rose to 79%, while the tax rate on corporate profits and dividends—which had been 11% in 1929—was increased to 19% in 1938, 38% in 1940, and 44% in 1941 (18). And when some firms attempted to evade the impact of the higher taxes on dividends by keeping a larger proportion of their profits as retained earnings, they were hit with a tax on retained earnings, one which had rates as high as 70% (18).

Domestic economic policies were not alone in inflicting harm on American businessmen. Salsman asserts that even foreign policy contributed to the awful state of affairs during the 1930s. Here the error was Washington's "appeasement of fascism in Europe and Japan" (2005, 15). By remaining technically neutral, the United States government "emboldened" such dictators as Mussolini and Hitler. "The result was an inhospitable business climate[18] in Europe and Britain, which indirectly harmed American business . . . [because it] sabotaged investor-business confidence" (15).

Despite the burdens that had been put on the private sector, the American economy actually showed some signs of recovering during the mid-1930s, but this Rooseveltian onslaught of anti-capitalist legislation drove it into a sharp decline in 1937 and 1938. Production and profits fell, while unemployment rose to about 20%. Complete recovery was slow, and truly prosperous conditions would not return until after World War II.

> FDR imposed a raw deal on America's great producers—a relentless and unpredictable[19] avalanche of executive orders, laws, decrees, mandates, rules, regulations, and confiscations aimed solely at punishing and curbing wealth-creation. By 1940, FDR had succeeded only in keeping the U.S. economy as depressed as Hoover had left it eight years earlier. (Salsman 2004c, 20)

It is very widely assumed that, regardless of their cause, the solution to the economic problems of the 1930s was World War II. Between 1942 and 1945 aggregate production seemed to rise substantially and unemployment appeared to fall, so the massive government expenditures of the war years give the appearance of having boosted the economy. Many economists had by that time come to agree with John Maynard Keynes that the preceding depressed conditions were due to "inadequate demand" rather than to the constraints imposed on business firms. Thus, they believed that "war, wealth-destruction, fiat paper money, slave labor, and senseless make-work schemes were keys to prosperity" (Salsman 2005, 16).

Salsman categorically rejects such a view. "[G]overnment does not and cannot create wealth; it can only borrow, steal, or destroy it. These last three methods were used . . . during World War II. . . . War can only reduce or impede prosperity" (17, 20). Perhaps the most dramatic effect the war had was on unemployment. Salsman declares that sixteen million Americans were conscripted to serve in the armed services,[20] and over one million were either killed or wounded (17). Removing millions from the civilian labor force and putting them in uniform drastically lowered the official unemployment rate. But such official data are flawed. Salsman prefers to think in terms of those who contribute to the creation of wealth, versus those who do not. Therefore, he counts as *unemployed* not only those in the private sector who were without jobs, but also those who worked as government bureaucrats and those who were military conscripts. By this measure,[21] the rate of unemployment was 23% in 1940, rose to 36% in 1945, then fell back to 17% in 1950 (18). Even for those who were productively employed, living standards declined markedly. Private sector investment fell by 40% from 1941 to 1945,

price and wage controls were pervasive, the production of many consumer goods was effectively prohibited, people worked longer hours and suffered more occupational injuries, 35% fewer young people earned college degrees, the number of new patents decreased, even the divorce rate rose by 90% (18–20).

It was indeed a time of massive national sacrifice. It was by no means a time of prosperity. All the while, of course, the federal government was spending vast sums on the war effort. This brought about higher taxes. The highest marginal income tax rate rose to 94%, while even those in the lowest income tax bracket saw an increase from 4% in 1940 to 23% in 1944 (18). The rate on corporate profits went from 19% to 53%. Meanwhile, new approaches to generating tax revenues were introduced. In 1942, for the first time, a federal tax on the capital gains from sales of assets was imposed. Even worse, in that same year Salsman notes that the practice of tax withholding from workers' paychecks was adopted (18).[22]

If the "spend-and-tax" environment of World War II did not end the Great Depression, what did? Salsman informs the reader that "the Great Depression ended and lasting economic recovery began only after FDR died (April 1945), Germany surrendered (May 1945), and Republicans regained control of Congress. . . . Economic freedom was increased across the board in the years after FDR's death and the end of the war and during the steady accumulation of GOP power in Congress" (21).

Republican control of Congress was crucial to the recovery process because, once that control was established, Republicans launched a number of pro-capitalist reforms. These may not have constituted true laissez-faire, but they did significantly lighten the legislative and regulatory burdens that had been imposed, in ever increasing number, since Hoover took office in 1929. For example, many industries were freed of wartime production controls, wage and price controls were lifted, income tax rates fell, federal spending dropped by 68%—which brought about budget surpluses for the first time since 1930—and labor union excesses were curbed somewhat with the passage of the Taft-Hartley Act of 1947 (21–22). Moreover, monetary conditions improved with the Bretton Woods Agreement of 1945, which reestablished the convertibility of the dollar into gold.[23] And international trade was boosted because the General

Agreement on Tariffs and Trade (GATT), to which the United States was a party, "slashed tariff rates by half" (22).

How much did Gross National Product (GNP)—or some other common measure of output or income—rise as a result of these beneficent reforms? How much did unemployment fall? Surprisingly, Salsman does not tell the reader. His only quantitative evidence[24] for the success of these changes is that "[c]orporate profits and dividends doubled between 1946 and 1950, while the Dow Jones stock-price index rose 40%" (22). Qualitatively, he does state that investment spending rose, while the rate of unemployment declined (22).

Salsman concludes with the following triumphant, and self-congratulatory, declaration:

> Such is the tragic legacy of the Great Depression: a crime committed by statists, for which statists have been held blameless, so that statist elements might remain intact and sacrosanct, forever. Yet armed with facts, with the certainty reason makes possible, and a commitment to objective scholarship, the cause and consequences of the Great Depression can be understood, finally. And then the battle for capitalism should become that much easier to wage. (23)

A General Assessment

It is difficult to assess this Jekyll-and-Hyde effort. To adopt Salsman's own purported standards, as cited immediately above, would be eminently reasonable. That is, starting with a commitment to *objective scholarship*, one should apply careful *reasoning* to correctly stated *facts* in order to attain a conclusion of which one can be *certain*. But Salsman's own essay exhibits, at particular points, a lack of objectivity, incorrectly stated "facts," misapprehension of key ideas, and faulty reasoning (at this time, if readers of the present paper have not been reading the Notes at the end—especially numbers 4–7, 9–11, 14, 15, and 20–23—they should do so before continuing because they document some of these flaws). However, his numerous factual errors, though always disconcerting, are sometimes not critical to his argument.

For example, the more significant of the two Glass-Steagall Acts was signed by Roosevelt, not by Hoover, as Salsman claims. But his

principal point is that such legislation harmed the economy, and that remains true, regardless of which president signed the act. Or take his statement that Roosevelt conscripted sixteen million men in World War II. In fact, some sixteen million men and women served, but "only" ten million men were conscripts. The others volunteered. Does this fundamentally affect Salsman's criticism of FDR as a president who subjected millions of men to "slave labor" (2005, 17) by drafting them? No, it does not. Indeed, it is correct to say that Salsman's most basic assertion—that government intervention (of some kind) brought about the Great Depression—is absolutely right. In addition, he drives this point home with passion as well as with an avalanche of data, of which much is factually accurate. The many transgressions by Hoover and Roosevelt did have negative effects on the economy. And the business-friendly attitudes of Harding and Coolidge were surely helpful to the private sector. Salsman's essay, like the fictitious Dr. Jekyll, has some noteworthy virtues.

There are, however, very grave flaws as well. Mr. Hyde lurks in the shadows. One of these flaws can be despatched with some ease, because it involves a claim that is blatantly false. Salsman repeatedly refers to certain governmental actions under Hoover and Roosevelt as constituting "burdens," "impositions," and "interventions." Indeed, they were—at least to the honest entrepreneurs who sought no political favors—but he never even hints at the possibility that some businessmen actively lobbied for these incursions so as to gain at the expense of their competitors and customers, and even to rake in as much corporate welfare as possible. One can only conclude that in Salsman's view American businessmen were always the wholly innocent victims of a "war on business" (2004c, 13).

This is an absurdly inaccurate picture of American history. Many counterexamples could be cited, but a few should suffice. For instance, during the late nineteenth century "[r]ailroad promoters actively lobbied for land grants and other subsidies at every level of government. A chorus of manufacturers continually cried out for tariff protection" (Higgs 1987, 81).[25] World War I "awakened many businessmen to the lucrative possibilities of working more closely with government. . . . To develop and systematize this potentially fruitful 'partnership,' businessmen during the twenties created or expanded many trade associations" (154). In the Great Depression,

farmers, who wanted higher prices for their products, agitated for the Agricultural Marketing Act of 1929, the creation of the Agricultural Credit Banks, and the Agricultural Adjustment Act of 1933 (175). And the supporters of the National Industrial Recovery Act of 1933 "included businessmen seeking higher prices and barriers to competition" (177). Even such notorious pieces of supposedly pro-union legislation as the Norris-LaGuardia Act of 1932 and the Wagner Act of 1935 were actually promoted by "an important sector of the business community," which included executives of such famed firms as Standard Oil, J. P. Morgan & Co., General Electric, and Goldman, Sachs (Reynolds 1982, 258).

To deal with certain other problems will require more time and effort, because they involve misunderstandings and/or ignorance of certain economic concepts. The concepts of concern have to do with the nature and source of business cycles. So one must start with Salsman's position. He justifiably criticizes Hoover and Roosevelt (and the Congresses that collaborated?) for pursuing an anti-capitalistic agenda. But were these actions by the executive and legislative branches of government the *primary* cause of the severe expansion/contraction story of the 1920s and 1930s? Or were they *secondary* factors that merely intensified the cyclical swings in the economy? The present writer will maintain that to think they were the primary cause is to *misunderstand what business cycles are*. Therefore, this is where the most serious trouble begins.

In a passage central to his argument, Salsman maintains that "[i]n general, businessmen and investors cannot plan or operate efficiently amid extreme volatility—especially political-legal volatility. The New Deal was political-legal volatility *squared*"(2004c, 11). Legislation was generally anti-business, and undertaken on an ad hoc basis. Such unstable policies were, allegedly, the result of a philosophical deficiency on Roosevelt's part. That is, being a pragmatist at heart, FDR lacked an "integrated view of existence and the moral-political code that went with it" (2004c, 11).[26] In such a chaotic political context, businesses had no hope of operating profitably. By contrast, the years of Harding and Coolidge had provided a safe and stable environment, and the economy flourished. This then is Salsman's theory of business cycles: whenever legislation is predictable and friendly to the free market, the economy expands; whenever legislation is unpredict-

able and hostile to the free market, the economy contracts. But these expansions do *not* lead unavoidably to some subsequent contraction. There is no causal link between "boom" and "bust."

He is, moreover, not content simply to offer his own theory regarding the cause of the Great Depression. He is equally intent on condemning all other theories. All allegedly deserve condemnation because they have contributed to the "standard fable" about the Great Depression. That is, they have denied that the prosperity of the 1920s was real and sustainable and, thus, they have maintained that the Great Depression was the inevitable result of a preceding artificial "boom." This fable, this "tissue of falsehoods," he says, "is part Karl Marx, part John Maynard Keynes, part Milton Friedman, part Ludwig von Mises, and part Alan Greenspan" (Salsman 2004a, 17–18). That is a truly stunning pronouncement.[27] How can anyone lump together the inadequate demand of Keynes, the disproportionality of labor of Marx, the expectations-augmented Phillips curve of Friedman, and the capital malinvestment of Mises?[28] To do so is to be oblivious to some important conceptual differences. Salsman dares to group them under the same ideological tent on the grounds that "[a]ll sides of the debate say investors are irrational and free markets fail" (22). As questionable as that latter characterization may be, this issue must nonetheless largely be set aside, since the present writer is not particularly keen on leaping to the defense of Friedman, much less Keynes or Marx.[29] But Austrians such as Mises certainly do not deserve such treatment.

In Defense of Austrian Economics

To what extent Salsman has broad objections to the Austrian School is not clear from the essay being discussed here. What is clear is that he roundly condemns the Austrian Business Cycle Theory (hereinafter ABCT).

> In the Austrian theory of business cycles, it is easy to detect a lack of appreciation for the intelligence, wisdom, and foresight of entrepreneurs, businessman [sic], and investors. Austrian economists presume producers are easily fooled by government manipulations of money, credit, and the economy—especially by the alleged phenomenon of "artificially"

> low interest rates. They claim producers are conned into undertaking projects that later will turn out badly and require liquidation. In fact, producers are not fooled; they know, even if implicitly, which government policies are conducive to wealth creation and which are destructive. (23)

And what of a closely related issue, the spectacular rise in stock prices during the 1920s? The view "held by many supposed free-market economists—monetarists and Austrians" that increases in the money supply were the cause "could not be more wrong" (20). Why? Because "no new money supply ever 'goes into' or 'comes out of' any stock market. For every buyer of a stock, there is an equal and opposite seller. . . . The stock buyer transfers his supply of money from his bank account into the bank account of the stock seller. There is no net change in the money supply . . . stock-price moves [in the 1920s] had nothing to do with the money supply" (21). However, Salsman does grant that "stock prices are heavily influenced by interest rates," as well as by corporate profits (21).

This topic of the relation between the money supply and stock prices Salsman has somehow contrived to get hopelessly backward. He has entirely misconceived what Austrians are saying. No Austrian claims that the sale of stock shares brings about an increase in the money supply, as Salsman seems to think. What Austrians are claiming is that if excess money balances have been created, then a portion of that excess is likely to be spent on stocks. In other words, the demand for such assets rises, driving up their prices.[30] One wonders how Salsman can make such an elementary error, especially since it bears on issues to which he devotes much attention.

If the foregoing causes one to begin to question the depth of Salsman's economic knowledge, it should. But there is much more. The unhappy truth is that, based on the essay at hand, Salsman sometimes has only a tenuous grasp of the ideas of not only those he attacks (such as Austrians) but also of those he admires (such as Jean-Baptiste Say). This is revealed dramatically by his failure to recognize that a) ABCT has roots in the writings of Say himself, and Austrians share Say's positive view of entrepreneurs, b) a notable book by British economist Lionel Robbins—whose work Salsman castigates as being devoid of *any* theoretical framework—was in fact a clear

application of ABCT, and c) his own approach to the Great Depression offers no explanation of what is really the central issue in business cycle theory: the transformations in the capital structure. Each of these deserves close examination.

Salsman emphasizes what he sees as profound differences between the classical economics of Say and the Austrian economics of Mises, Hayek, and Murray Rothbard.[31] Viewed through his eyes, Say declares that greater production is always the route to greater consumption, producers are heroic because they are the creators of wealth, and there can never be such a thing as "too much" production. Business cycles have vanished from the economic landscape. Austrians, per Salsman, think that businessmen are productive but gullible (and thus not terribly admirable), that over-production can indeed occur in the economy, and, when such over-production arises, there will later be "some inevitable 'bust' sent as a punishment[32] for 'too much' prosperity" (23).

This sounds as if there is an unbridgeable gulf between Say and the Austrians. The reality is a bit different. First of all, Salsman has probably read too much into Say's Law. Though his presentation of this famous principle is not very precise—something that can be said of numerous portions of his essay—he clearly wishes to convey to the reader that a state of general over-production (often called a "general glut" in Say's time) is "impossible"[33] (2004b, 17). General over-production means that, across the economy, more goods have been produced and offered for sale than are demanded by consumers. Therefore, many goods go unsold. But does this mean that, in a free market economy, recessions and depressions cannot occur? No. "The classical economists were never guilty of the absurdity of denying the existence of depressions, unemployment, or unsold goods, as sometimes claimed in the literature" (Sowell 1974, 43). The classical explanation of why such contractions occurred is of crucial importance, in part because it reveals a powerful commonality with the Austrians. "They [classical economists] recognized such phenomena as effects of production that was internally out of proportion as far as product mix was concerned, but *not* excessive in the aggregate" (43). Jean-Baptiste Say ([1880] 1971, 135) put it this way:

But it may be asked . . . how does it happen . . . that there is

> at times so great a glut of commodities in the market, and so much difficulty in finding a vent for them? Why cannot one of these superabundant commodities be exchanged for another? I answer that the glut of a particular commodity arises from its having outrun the total demand for it in one or two ways; either because it has been produced in excessive abundance, or because the production of other commodities has fallen short.

In his third *Letter to Thomas Malthus*, Say (1821) elaborates on this theme when he takes note of the disorders frequently occasioned by excessive costs, where those costs bring about an imbalance in production. Some goods are much too plentiful, and other goods are far too scarce. Again, the core problem is not the aggregate level of production, but the product mix. This concern with the proportions of different categories of goods is "pregnant with hints of the later Austrian theory of the trade cycle" (Rothbard 1995, 36). No doubt Rothbard makes this comment because one of the most distinctive aspects of ABCT is the focus on an imbalance between "higher order" (capital) goods and "lower order" (consumer) goods. That is, as the supply of credit rises and real market interest rates fall below the natural rate of interest,[34] entrepreneurs are led to invest in capital projects of greater duration. As a result, the mix of capital goods relative to consumer goods rises. Those capital goods that are not supported by an increase in saving, but merely by the central bank's increase in credit, will prove to be "malinvested." To correct this, some projects will have to be liquidated, and many firms will experience losses. The net effect of this process is to stimulate an unsustainable expansion, which then must at some point be followed by a contraction in overall economic activity. The Austrian analysis is far more detailed and sophisticated than Say's, but they share a common insight: that the primary cause of cycles is an *imbalance in the structure of production*, not excessive production per se.

The critical figure in the arrangement of that structure of production is the entrepreneur. Salsman portrays Say as holding entrepreneurs in high esteem, while Austrians allegedly not only have too little regard for entrepreneurs' wisdom and intelligence, they also are convinced that entrepreneurs are easily led astray by monetary and

credit conditions. First of all, one may recall that Salsman himself readily concedes that entrepreneurs do fall prey to "political-legal volatility." One may reasonably assume that here volatility refers to the amplitude and/or the rapidity of changes in laws and regulations. Which is subject to greater volatility then: changes in regulations and taxes, including tariffs, or changes in money, credit, and interest rates? Since it may take months to pass a bill through Congress, but the Federal Reserve can affect tomorrow's interest rates merely by today announcing its intention to change the discount rate, it seems undeniable that financial markets exhibit much more rapid changes than does the "political-legal" environment. Changes in amplitude may be large in either case. That is, the income tax rate may double, but so too may the rate of growth in the money supply. All things considered, there seems to be no reason to think that political-legal volatility is systemically greater, and thus more prone to produce business errors, than is monetary-financial volatility. If anything, the reverse is the case.

Salsman insists that Say has a very positive, and the Austrians a rather critical, attitude toward entrepreneurs. Actually, contrary to this claim, one can come to virtually the opposite conclusion, depending on which passages one selects to read. It is true that Say (1821) praises producers of all kinds. But it is also true that he realized they—like all humans—are capable of grievous error:

> This superabundance, as I have already remarked, depends also upon the ignorance of producers or merchants, of the nature and extent of the want in the places to which they sent their commodities. In later years there have been a number of hazardous speculations, on account of the many fresh connexions with different nations. There was every where a general failure of that calculation which was requisite to a good result; but because many things have been ill done does it follow that it is impossible, with better instruction, to do better? I dare predict, that as the new connexions grow old, and as reciprocal wants are better appreciated, the excess of commodities will every where cease; and that a mutual and profitable intercourse will be established. . . . Such is the doctrine established in my works.

In the above, Say's first point about the failure of economic calculation under adverse conditions clearly runs parallel to the Austrian claim that capital can be malinvested any time that interest rates are subject to the machinations of a central bank. And the latter comment about correcting one's miscalculations anticipates "Hayek's important point about entrepreneurs and producers employing the market as a learning experience, to become better at estimating costs and demands" (Rothbard 1995, 36). If Salsman were correct, one might be hard pressed to find praise for entrepreneurs among the Austrians. But it is in fact easy to discover the great importance that, for one prominent example, Mises ([1949] 1966, 255) places on entrepreneurship. "[Entrepreneurs are] those who have more initiative, more venturesomeness, and a quicker eye than the crowd, the pushing and promoting pioneers of economic improvement . . . [t]he driving force of the market, the element tending toward unceasing innovation and improvement." Mises is far from standing alone among Austrians on this. For instance, Israel Kirzner (1973, 8) says "I will maintain that [in mainstream economic literature] the proper role of the entrepreneur in the market system is not typically presented in its true light, or with adequate recognition of its being the driving force for the entire market process." And Rothbard (1995, 25) joyously praises Say for treating the entrepreneur as "the linchpin of the economy."[35] It is simply inaccurate and unfair to paint Austrians as having little appreciation for entrepreneurs and their place in the economy. Regarding this issue—and others—the respective viewpoints of Say and the Austrians far more nearly converge than diverge.[36]

If one is effectively to disprove a theory, surely the first requirement is that one be able to recognize it. Salsman (2005, 22) fails to meet even this minimal requirement. Immediately after declaring—yet again—that the "defect in the Austrian account . . . is its dubious claim that" the boom of the 1920s was unsustainable and had to be followed by the depression of the 1930s, he reveals that "there's a view of the stock-price crash and depression that is far worse than the falsehoods of those who've adopted definite interpretations of these episodes [such as the Austrians], for it's an approach mired in skepticism and the arbitrary, as exemplified by *The Great Depression*, a 1934 book by the late British economist Lionel Robbins." Salsman

is convinced that this work is irretrievably lost in contradictory details[37] and that it is based on no known theory of business cycles, that it exhibits "the inability (or refusal) to seek and find a single, unified theory" (23).

It is, at first, difficult to believe that Salsman means this seriously. The reason for such bewilderment is simple. *The Great Depression* by Lionel Robbins has long and widely been known as an application of the Austrian theory of cycles. Both external and internal evidence for this can be found easily. For instance, prominent Austrian macroeconomist Roger Garrison (2003) refers to "Lionel Robbins, whose 1934 *Great Depression* was a skillful application of Hayekian theory to the boom and bust of the interwar period." Elsewhere, Garrison repeatedly categorizes Robbins' early work as Austrian (2001, 72, 216, 240). Furthermore, Robbins wrote a laudatory Foreword to the 1932 American edition of Hayek's *Prices and Production*, one of the standard Austrian works on business cycles (Mises 1990, ix). And in an Introduction to Mises' *The Theory of Money and Credit*, Robbins ([1934] 1971, 12) praises Mises' "extensive treatment of the problems of modern banking and the effects of credit creation on the capital structure and the stability of business."

Despite all the foregoing, Salsman might resort to a strategic retreat. He might now grant the obvious, that Robbins thought highly of the Austrian theory, but still insist that Robbins never employed it himself. Nothing could be more wrong. Somehow Salsman is unaware of it, but early in the very book he criticizes so severely, *The Great Depression*, one finds:

> Let us suppose that . . . the Central Banks of the world make their rates of discount lower than would be justified by the volume of voluntary saving. . . . The structure of interest rates has fallen. This means that the profitability of all forms of production which involve making things which only yield services at a later date, or over a long period of time, is increased. . . . There will be an increased demand for what we have called capital-goods. . . . [This is] almost exactly similar to the phenomena we should expect to accompany a fall in the rate of interest which was due to an increase in voluntary saving. But there is an important difference. An

> increase in voluntary saving . . . involves a proportionate slackening of expenditure on present consumption, and a proportionate increase of expenditure on making things which will only be consumable in the future. But the change we have been describing involves a change in the amount spent on capital-goods without any diminution . . . of expenditure on consumption-goods. . . . But this means that the anticipations on which the producers of capital-goods planned their extensions of production are frustrated. . . . Investment in the lines of industry most affected by the rate of interest is seen to be unprofitable. . . . So much by way of bare essential outline of the manner in which an inflationary extension of credit may generate collective error on the part of the producers of capital-goods. (Robbins 1934, 36–39)

This, though but a brief sketch, is *precisely* the theory Austrians present as the explanation for the Great Depression, and for cycles in general. Mises himself could scarcely have done better in summarizing ABCT. Anyone who might question whether the above passage from Robbins actually matches standard presentations of ABCT can consult any of a number of different sources. (See, for instance, Garrison 2001, 67–83; Callahan and Garrison 2003; Mises [1934] 1971, 349–66; Rothbard [1963] 1975, 17–25; Cochran and Glahe 1999, 83–149; Mises [1949] 1966, 548–80; Mises, Haberler, Rothbard, and Hayek [1978] 1996; Sechrest 2006; or Ekelund and Hebert 1997, 515–16.) Clearly, Salsman is wrong. Robbins most definitely does have a theory around which he frames his narrative of the Great Depression. Moreover, it is the very theory to which Salsman is so vehemently opposed. Why does Salsman fail to understand this? Did he actually not read all of Robbins' *The Great Depression* ? If he did not read it, then how can he criticize the book? If he did read it, then he must not comprehend ABCT well enough to recognize it when it is laid out in front of him.[38] If the latter is the case, one needs to remind Salsman that to condemn an idea that one really does not comprehend is a very questionable course of action.

On top of everything else, Salsman's essay never actually offers the reader a theory of business cycles, despite his being well aware of the need for a "unified theory" (2005, 23). Of course, Salsman

believes he has done just that. As he puts it, "the Great Depression was caused by *statism*"(23), by which he means the legislative and regulatory shackles put on businesses by Hoover and Roosevelt. Why then does this not constitute a theory of cycles? Because it conflates general business movements with business cycles. General business movements are responses to pervasive changes in factors such as technology, time preferences, taxes, and regulations. These determine the trend in economic growth. Business cycles are the fluctuations around that trend line, and they involve three widely-documented phenomena, all of which one must account for if one is to have a theory of sufficient explanatory power (Rothbard [1963] 1975, 16–17). First, the normal profitability that stems from accurate entrepreneurial forecasting suddenly disappears, and the economy witnesses a surprising "cluster" of business errors. Further, these errors are all in the same general direction, so they must be caused, not merely by random individual ineptness, but by some common factor. Second, output prices and profits in capital goods producing industries rise *relative* to those in consumer goods producing industries during the expansion and fall *relative* to those in consumer goods producing industries during the contraction. So the proportion of aggregate output represented by capital goods rises during the expansion and falls during the contraction.[39] Third, the money supply always rises in expansions, and falls—or, in recent decades, rises at a slower rate—during the contraction. Cycles, in short, involve money, credit, interest rates, and above all the capital structure (Anderson [1949] 1979, 131–43).

Salsman denies the importance of money and credit, skips over the links with interest rates, and never even mentions the changing balance between capital goods and consumer goods. The issues he raises—changes in income taxes, tariffs, and regulatory restrictions, budget surpluses and deficits, and so forth—cannot explain why the prices and profits of, for example, the automobile and steel industries fluctuated more, both up and down, than did those of restaurants and department stores. ABCT can explain this, because it focuses on the discoordinating effects of market interest rates that have been driven below the natural rate of interest. This latter disparity creates an intertemporal imbalance. Resources are drawn into capital goods production in greater degree than can ultimately be sustained by the

level of voluntary saving. Greater profits and greater production are initially the result. Nevertheless, sooner or later projects must be liquidated, firms experience losses, and, since the reallocation of resources to redress the imbalance takes time, the economy will for a time contract in terms of aggregate activity. Austrians think that changes in the money supply and thus in the capital structure are crucial insofar as cycles are concerned because, to be eloquently succinct, "capital gives money time to cause trouble" (Garrison 2001, 8).

Is this "trouble" rooted in some deficiency, such as stupidity or ignorance, on the part of entrepreneurs? Salsman repeatedly insists that Austrians believe exactly that, but, once again, he is in error. "The Austrian theory of the business cycle does not rely on entrepreneurs being slow or unable to learn" (Callahan [2002] 2004, 235). The market process is a process of discovery, one which unfolds over time. Entrepreneurial expectations are *endogenous* to the market (Garrison 2001, 76–83). Entrepreneurs learn as quickly as the market reveals information. But it should be obvious that alterations in the capital structure—the heart of the business cycle—are far from instantaneous (Sechrest 2006). And interest rate changes, though occurring with rapidity, do not immediately convey whether the change is temporary (the result of central bank manipulation) or permanent (the result of a change in time preference) (Garrison 2001, 78). Therefore, both the upward and downward turning points in the cycle provide incentives that may well be irresistible, regardless of how well most entrepreneurs grasp the underlying economic fundamentals (Carilli and Dempster 2001). Even if the more perceptive businesspeople try to abstain from the enticements of an unsustainable expansion, they cannot afford to. The *marginal* entrepreneurs will take advantage of the easy credit conditions, precisely because they were the ones excluded previously. This drives up resource costs for all, virtually compelling even the most circumspect to seek additional funding, even if only to keep their existing projects going.

Cognitive Dissonance

The present writer would be remiss if he did not say something about those further parts of the essay where Salsman jars the perceptive reader with some rather odd declarations. Above, in the

course of examining certain key issues, some of these have already been noted, such as the nonsensical "argument" that money has nothing to do with stock prices because a stock trade does not alter the overall supply of money. Regrettably, there are more. One of the more significant examples may not, at first glance, be an obvious flaw. Salsman emphasizes that the 1920s were a time of great—and true—prosperity. These years were also characterized by a fun-loving, upbeat, "benevolence" (2004a, 20). In contrast to this he portrays the boom/bust theories of academic economists as indulging in the "malevolent-universe premise" that such prosperity cannot last, that "all good things must come to an end" (23). This is surely an error of logic on Salsman's part. Such would indeed constitute malevolence if these economists believed the "Roaring Twenties" were a time of genuine, sustainable prosperity and that such genuine prosperity somehow "deserved" the suffering that was the Great Depression.

However, that is *not* what they argue. To take Austrians as an example, the assertion is that the monetary growth undertaken by the Federal Reserve created—at least in part—an *artificial*, *unsustainable* expansion. It is hardly "malevolent" to believe that an unsustainable boom will inevitably bring on a subsequent contraction.

Or consider this: While explaining the events that led to the stock market crash in 1929, Salsman informs his readers that "the US government was now adopting—as official policy—the myth that stock prices (the value of businesses) could get 'too high,' that stocks could be 'improperly' priced. . . . Fed officials clung to the myth that stocks could be 'overpriced'—in effect, that businesses could be worth too much" (2004b, 16).[40] It is a *myth* that shares of stock can be overpriced? Does Salsman really mean that? Perhaps he simply meant to say that, in the specific historical period with which he is dealing and under the prevailing conditions, stocks were not in fact overpriced. But that is not what he actually says, so one is compelled to take him at face value. In which case, Salsman's assertion translates into the proposition that is known in academic circles as the "strong form" of the Efficient Markets Hypothesis (EMH). This is the statement that, at any moment in time, the current price of a stock already completely reflects all relevant information about that stock, which of course includes information known only to "insiders" and thus not publicly available. The unavoidable but obvious implication

is that no investor can consistently achieve above-average profits by trading stocks. Not surprisingly, there is heated debate over the validity of the EMH among economists and financial experts, so Salsman's claim is very much subject to doubt.

Furthermore, the EMH world is one in which "individual plans are perfectly coordinated, all profit opportunities have been exploited and there is no scope for entrepreneurship. . . . [EMH] discounts the importance of entrepreneurship by suggesting that an automaton can substitute for entrepreneurial activity" (Pasour 1989, 103–4). For an eager champion of capitalists, entrepreneurs, and investors such as Salsman, this EMH would thus seem to be a most unwelcome proposition. Then again, he is above all determined to counter the idea that monetary inflation during the 1920s fueled artificially high stock prices. Apparently he is willing to bed down with the EMH, as long as that drives the Austrians out of the house altogether.

There is one final thing concerning stock prices. The present paper earlier grappled with Salsman's statement that the supply of money has nothing to do with stock prices. But one may recall that Salsman did in fact concede that "stock prices are heavily influenced by interest rates" (2004a, 21). So stock prices are not affected by changes in the money supply, but they are heavily influenced by interest rates? Instantly, there is a conundrum to be faced. Are not interest rates (and thus by derivation stock prices) affected by changes in money? Yes. All economists will agree that market interest rates are, in part, a function of the money supply (though they may disagree about the rapidity of the effects, whether real or nominal rates are changed, and so forth). Therefore, Salsman is flying in the face of fundamental economic principles. He must think that interest rates are driven solely by something entirely unconnected to changes in money and credit conditions.

Indeed, Salsman does offer a candidate for the driving force in question. It is time preference, which he actually explains rather well in terms of long-range thought and action (reflecting a low rate of time preference) versus short-range thought and action (reflecting a high rate of time preference). The former allegedly led to the falling market rates in the 1920s (22).[41] He is correct, up to a point. That is, the natural rate certainly is determined by the interactions among individuals' rates of time preference. But he fails to note that the

natural rate of interest is an equilibrium rate, that at which the *ex ante* quantity of funds voluntarily saved equals the *ex ante* quantity of funds demanded for investment. Even more critical is Salsman's failure to differentiate the natural rate from the market rate. The latter is the rate at which the quantity of credit supplied equals the quantity of credit demanded.

The market rate will, in any central banking regime, sometimes depart from the natural rate, because the supply of credit is vulnerable to manipulation by such a monetary authority. To be more precise, whenever the monetary base is increased via, for example, central bank purchases of government debt instruments, banks have more reserves with which to make additional loans and create additional deposits. Both the supply of *money* and the supply of *credit* rise. Therefore, market interest rates—the price of credit[42]—decline, at least initially. If there has been no change in time preferences and thus the natural rate, then market rates fall below the natural rate, and the cyclical sequence so well explained by ABCT begins. Salsman's truncated presentation effectively eliminates any possible gap between the market rate and the natural rate. At the same time, it defines out of existence any possible impact of money on stock prices, since it severs the connection between money and interest rates.

If all that were not baffling enough, one cannot overlook an incongruity that, on Salsman's own terms, really should be troublesome. He insists that the factors that influence time preferences (and thus interest rates) include "the political-legal context . . . rates of taxation, and the uncertainties associated with regulation or war" (21). Based on his own detailed narrative, the 1920s were a time of low taxes, little regulation, and a business-friendly political environment. The 1930s were the opposite. Therefore, by his own account, the 1920s should have seen low or falling interest rates and the 1929–41 period should have been burdened with high or rising rates. The facts stubbornly refuse to fit this scenario. Corporate bond yields (the measure that Salsman uses) did fall between 1920 and 1928, as he claims. However, Moody's Aaa bond yield, which rose from 4.70% in March 1929 to 5.32 % in December 1931, then fell to 4.68% in March 1933, 3.32% in March 1937, and 2.80% in March 1941. The data for Moody's Baa bonds follow a very similar pattern. (To verify this, see online: <http://research.stlouisfed.org/fred2/data/

AAA.txt>; <http://research.stlouisfed.org/fred2/data/BAA.txt>.) Interest rates in the administrations of Hoover and Roosevelt not only were falling, they also were generally lower than they had been under Harding and Coolidge. There must have been something *other than* just time preferences that was significantly affecting market interest rates. And of course there was: changes in money and credit engineered by the Federal Reserve.

Finally, one has to wonder why Salsman never mentions the Fordney-McCumber Tariff Act of 1922. He dwells at length on the damage done by the Smoot-Hawley Tariff of 1930, but ignores this earlier legislation. Its absence from the essay is significant because, under its provisions, average tariff rates were only about 2.5% less (38.5% versus 41%) than they were to later be with the notorious Smoot-Hawley. Moreover, this act precipitated a trade war just as did Smoot-Hawley. "With the passage of the Fordney-McCumber Tariff in 1922, the United States had, for a creditor country, one of the highest tariff rates in the world. After failing to convince the United States to lower its tariff duties, European and Latin American countries decided to retaliate and raise their duties" (Kaplan 2008).

Obviously, the passage of such legislation is not entirely consistent with Salsman's portrait of Harding and Coolidge as presidents who advocated low taxes and free markets.[43] But it is nevertheless true that the 1920s were a time of great apparent prosperity. Constrained by such a tariff burden, how did the economy expand so strongly? Once again, Austrians have an answer. Despite the presence of such drags on business as the Fordney-McCumber Tariff, monetary growth provided an even greater stimulative effect. However, because of its distorting effects on the structure of production, this monetary growth produced an expansion that could not be sustained.

Some Closing Thoughts

Woven throughout the fabric of Salsman's essay is a rather striking vision of American businessmen. In this "subtext," one can locate both praiseworthy virtues and condemnable flaws. At a deep emotional level it is, one surmises, that message that Salsman most dearly wished to convey. By his account, businessmen are the heroes who call upon their initiative and intelligence in order to restructure

the resources of Earth, thereby creating the wealth from which we all benefit. They struggle on, often burdened by outrageous laws and regulations, not because they are Christ-figures who choose to suffer for their fellow men, but because they profoundly, egoistically enjoy the act of creation.

So far, so good. But Salsman goes further. He insists that these producers cannot be deceived. They "know when it's worth producing and when it's only worth shrugging" (2004a, 23). They also buy and sell stock shares, but such shares are never overpriced. They invest millions in capital projects but never at artificially low market interest rates, because they are never fooled by the interest rate shenanigans of the Federal Reserve. In addition, Salsman's businessmen are innocent of any wrongdoing. They never seek government favors, never lobby for corporate welfare, never try to gain at the expense of their competitors. They never miscalculate. They are without error, either factual or moral. What can one say? These are not real businessmen that he portrays. They are cardboard cutouts.[44]

Richard Salsman had an admirable goal in mind, a goal with which the present writer utterly sympathizes. He wanted to defend capitalism against the "slings and arrows" of statists of all stripes. He wanted to set the record straight about the Great Depression. It did not constitute a massive "market failure" but a colossal government failure. One could not agree more. But along the way, Salsman also was determined to demonstrate that *he alone* knew the true cause and consequences of that momentous event. All economists had it wrong, even the passionately laissez-faire Austrians. Tragically, in his rush to convince the reader of this, he cast aside fair-minded scholarship, clear reasoning, and many inconvenient facts. The result is largely a tortured, muddled mess.

Acknowledgments

The author would like to thank Chris Matthew Sciabarra for bringing Salsman's essay to his attention and for suggesting that he write a response to it.

Notes

1. The word fable is in quotes merely because Salsman uses that exact term. The present writer emphatically agrees that government intervention caused the Great Depression and, indeed, prolonged it.

2. This writer has long thought of the two basic branches of Objectivism as

"orthodox" and "reform," in imitation of the distinction between orthodox and reform Jews. Orthodox Objectivists are, generally, associated with the Ayn Rand Institute and usually engage in the exegesis of canonical works by Rand and, to a lesser extent, Leonard Peikoff. Reform Objectivists (or neo-Objectivists) are often associated with the The Objectivist Center/The Atlas Society (founded by David Kelley initially as the Institute for Objectivist Studies), or are entirely independent of any formal organization and are usually interested in exploring the boundaries of Objectivist principles. The former see Objectivism as a closed system; the latter see it as an open system. All indications are that Salsman is an orthodox Objectivist. Insofar as economic analysis is concerned, members of both groups have often praised the Austrian School, though an undercurrent of hostility to Austrians has been evident for some time among the orthodox. Such hostility has reached full bloom with Salsman's essay.

3. Please note the reference to benevolence. Salsman will also employ the contrasting notion of a malevolent worldview in his critique of business cycle theories. This theme of benevolence vs. malevolence will be discussed in a later section.

4. It is curious that he deals only with federal taxes and entirely ignores taxes at the state and local levels. This is particularly unfortunate because, for example, local property taxes represented a considerable expense to the average citizen, and they "increased significantly in the decade prior to the Great Depression" (Thornton and Weise 2001, 97). Thus, property taxes were rising at the same time that federal income taxes were falling.

5. Unfortunately, the official rate of exchange between gold and the British pound was set at a rate that failed to reflect the inflation that had occurred in Britain since 1914 (Anderson [1949] 1979, 171–72). Therefore, the official rate *over*valued the pound-sterling and thus set in motion Gresham's Law. This is the proposition that, for any two co-existing forms of money, the officially overvalued money will be used for transactions, while the officially undervalued money will be saved as an asset. Thus, the officially undervalued money—in this case gold—will be driven out of circulation. It is puzzling that Salsman sees no particular problem with this state of affairs, given that 1) he seems to be strongly in favor of gold as an economy's base money and 2) he surely is opposed to the imposition of price controls of any kind (what Britain did was to set a price ceiling on gold at the same time that it set a price floor on pounds). Moreover, a further effect of this inappropriate official exchange rate was to diminish British exports (Rothbard 2002, 357). This should be a regrettable state of affairs for someone, like Salsman, who wants to promote greater international trade. Finally, Salsman fails to recognize that this regime was not a return to the classic gold standard, but was, instead, a gold-exchange system that "broke the classical gold standard's stringent limits on monetary and credit expansion" (385).

6. Please note that Salsman apparently considers the demand for money to be a positive function of only one variable: industrial production. It is difficult to imagine how this could be true. Probably no professional economist would agree with such a proposition. Usually, the demand for money is seen as driven by several factors. These typically include some measure of aggregate output or income, such as National Income or Gross Domestic Product, wealth or "permanent income,"

interest rates, and commodity prices. Taking one common aggregate measure, nominal Gross National Product, one sees an increase of 48% ($69.6 billion to $103.1 billion) between 1921 and 1929, less than half the rise in industrial production used by Salsman (Bureau of the Census 1975, Series F 1–5; 224). Also, other researchers give very different figures for money supply growth. Instead of the 29% cited by Salsman (which is for currency plus checkable deposits), Benjamin Anderson claims that, between April 1921 and April 1928, for commercial banks that were members of the Federal Reserve System, the growth in demand deposits was 33.8% and that in time deposits was 135.1%—these being the two principal components of the overall supply of money. And for all American commercial banks, total deposits increased by 44.1% between 1922 and 1928 ([1949] 1979, 149–50). Rothbard ([1963] 1975, 88) says the money supply rose by 61.7% between June 1921 and June 1929. In short, it looks as if Salsman may have *overstated* the rise in the demand for money and *understated* the rise in the supply of money.

7. Actually, this is not quite accurate, according to official data. The Bureau of Labor Statistics shows, on a year-to-year basis, that from 1921 to 1929 both the Wholesale Price Index and the Consumer Price Index experienced some increases and some decreases. Overall, both series fell slightly (Bureau of the Census 1975, Series E 73–86, 87–89, 135–66; 203, 211).

8. This is one of three interrelated, and very controversial, claims that Salsman makes. As he well knows, the first sets him in opposition to almost all economic schools of thought. As will be discussed later, the other two claims are that a) the Austrian theory of business cycles is incompatible with Say's Law and b) businessmen are vulnerable to volatile legislation and regulation, but not vulnerable to movements in money and credit. A fourth claim, made only implicitly and not directly related to the three noted above, is that American businessmen have not themselves been advocates of anti-capitalistic legislation or regulation.

9. At least on average, it appears that tariff rates under Smoot-Hawley rose much less than Salsman claims. Moreover, there is controversy about the extent to which the act affected trade (O'Brien 2001).

10. Here Salsman has made a serious error. There were two Congressional acts sponsored by Glass and Steagall, one in 1932 and one in 1933. The one that divided commercial from investment banking activities was the second, which was officially known as the Banking Act of 1933. Since it became law on 16 June 1933, it was signed by Roosevelt, not by Hoover (see Mester 1996; also see online: <http://www.u-s-history.com/pages/h1504.html>).

11. This is the name Salsman gives, but there seems never to have been such an organization. There was, however, a National Credit *Association* (Higgs 1987, 165).

12. If this makes it sound as if these groups were the entirely innocent victims of unwanted government intrusions, that is exactly the image that Salsman apparently wants to convey to the reader. The extent to which some businessmen were, in fact, accomplices to this array of Progressive policies will be examined later.

13. Inflammatory language such as this is, sadly, sprinkled throughout Salsman's essay.

14. This is yet another factual error by Salsman. Presidential Executive Order 6102 dated 5 April 1933 stated that the punishment was to be a fine of up to $10,000 and/or imprisonment for up to *10* years (see online: <http://www.the-privateer.

com/1933-gold- confiscation. html>).

15. Salsman is confused here. He calls this legislation the "National Recovery Act" and refers to it as the "NRA," when the NRA was not the act itself, but the organization that administered the act.

16. This brief description of Say's Law does not really do it justice. For one thing, there are several different propositions that have, at times, been taken as Say's Law. It is not clear whether Salsman understands this. In any case, for a thorough explication of these important ideas, one should consult Sowell 1972, especially pages 31–38.

17. Salsman misses a golden opportunity here by neglecting to cite a well known comment by Say: "Thus, it is the aim of good government to stimulate production, of bad government to encourage consumption" ([1880] 1971, 139).

18. One does not want to belabor the obvious, but does not a declaration of war produce the worst possible business climate? Certainly World War II did two things: 1) ended all business dealings with Germans, Italians, and Japanese for a period of several years and 2) left those Axis nations in ruins for several further years. It is difficult to see how that was particularly good for American businesses. Salsman himself later chronicles some of the counterproductive domestic effects of the war, but never mentions the loss of these markets during that conflict. Presumably, he is implicitly assuming that to defeat fascism abroad was worth the economic loss.

19. Salsman could be right that this anti-business program was both "relentless and unpredictable," but one has at least tentatively to question the second part of that proposition. A relentless presidential attack on free enterprise seems to suggest *qualitative*, even if not *quantitative*, predictability. Now, given that one can predict the general direction of an attack, it still can be true that one cannot fully insulate oneself from the adverse effects of the attack. The present writer certainly does not deny the catastrophic effects of Roosevelt's actions. He only is skeptical of the notion that they were highly unpredictable. As will be seen later, Salsman needs these legislative and regulatory acts to be highly unpredictable, because it is on them—rather than on Federal Reserve manipulations of money and credit—that he wishes to pin the blame for the Great Depression.

20. Actually, this badly overstates the case. "Of the sixteen million who served in the armed forces during the war, ten million were conscripts" (Higgs 1987, 202). Indeed, the very source Salsman (2004a, 24 n. 7) says he uses for all data—*Historical Statistics of the United States: Colonial Times to 1970*—itself gives the figure of 10,022,000 draftees out of total military personnel of 16,354,000 during the war (Bureau of the Census 1975, Series Y 856–903; 1140). On the one hand, this is a further example of sloppy "research" on Salsman's part. On the other hand, it is fair to note that some men no doubt volunteered only because there was the draft, and by volunteering they could, for example, join the Navy and thus avoid the most onerous duty: serving as an infantryman in the Army.

21. Salsman's numbers are quite plausible, but one wonders exactly where he obtained his data. Unfortunately, he gives the reader no details, other than the broad statement in Part 1 that all the data used in the essay appear somewhere in *Historical Statistics of the United States: Colonial Times to 1970* (2004a, 24 n. 7). Curiously, in Part 4, he changes that to the statement that "most" of his data came from *Historical*

Statistics (2005, 23 n. 1).

22. Once again, Salsman is off target. The Revenue Act of 1942 imposed a 5% "Victory Tax," but did not make withholding universal. It was the Current Tax Payment Act of 1943 that finally applied tax withholding to all workers. See online at: <http://www.irs.gov/irs/ article/0,,id=101101,00.html>.

23. Salsman correctly states that, under this international agreement, the price of a troy ounce of gold was set at $35.00. However, he neglects to make one very useful comparison: when Roosevelt took the United States off the gold standard (at least domestically) in 1933, the price was $20.67 per troy ounce of gold. In other words, between 1933 and 1945, the American dollar had depreciated about 69% relative to gold. That serves as a pretty good indicator of the effects of Roosevelt's policies on the American economy. Of even greater importance is the fact—never mentioned by Salsman (he merely says that it "wasn't a gold-coin standard operated by private banks")—that such gold convertibility only applied to international transactions. That is, foreign governments and foreign central banks could demand that the dollars they held be redeemed in gold, but American citizens could not. Therefore, the Bretton Woods system was a pale imitation of a real gold standard.

24. For some interesting economic details about this postwar period, see Vedder and Gallaway 1991.

25. To cite the work of economic historian Robert Higgs seems particularly appropriate here since Salsman himself has praise for Higgs (2005, 23 n. 1).

26. Here Salsman turns to work by Leonard Peikoff for an elaboration of the pragmatist approach.

27. At another point, Salsman (2004b, 20) goes so far as to make reference to the "Marxian-Austrian theory of 'boom and bust'." This label was probably intended purely as an insult to Austrians. Nevertheless, there is one commonality between Austrians and Marx. "Marx shares with his Austrian rivals an understanding of the *political* character of the business cycle. . . . Like Hayek, Marx sees the state as the source of inflation" (Sciabarra 1995, 77). One should hasten to add that this observation does not demean Austrians; it merely acknowledges that Marx, despite other deep errors, did possess some understanding of business cycles.

28. See Ekelund and Hebert 1997, 466–82, 497–500 for good summaries of Keynes and Friedman. For a brief review of the Austrian idea of malinvestment, see Rothbard [1963] 1975, 12–21. To understand Austrian macroeconomics more fully—and to see how it contrasts with Keynesianism, monetarism, and New Classicalism—one should read Garrison 2001. For one of the classic works on ABCT, one may turn to Hayek 1933. Regarding the Marxian view of cycles, consult Sowell 1985, 84–105.

29. For the present writer's thoughts on Alan Greenspan, see Sechrest 2005.

30. For further details on this process, see Rothbard [1963] 1975, 153–54.

31. It is worth pointing out that one prominent economist has recently produced a massive treatise in which, to a high degree, classical and Austrian economics are harmoniously reconciled (Reisman 1996). It is likely that Salsman's essay could have benefitted from some of the insights found in that work.

32. One wonders why Salsman couches this in such moralistic terms. Professional economists certainly do not discuss these issues in such terms.

33. In the fifth edition of his *Treatise*, which has never been translated into

English, Say apparently turned his back on the position he had earlier defended, as he "openly disavowed the doctrine that there were no short-run limits to production" (Sowell 1974, 47).

34. The natural rate (or pure rate, or originary interest) is a ratio that reflects how much a person discounts future goods against present goods. It is, therefore, a function of one's time preference. Time preference refers to the fact that all humans prefer present goods to future goods. But the rate at which one discounts the future varies among individuals and also may vary for a given individual as his circumstances change (Mises [1949] 1966, 526–27). Salsman, by the way, is familiar with time preference, as he employs the term in his essay.

35. More broadly, Rothbard calls Say's *Treatise on Political Economy* a "great" book that is written with "lucidity" and "clarity"and exhibits ideas that are "pre-Austrian" (1995, 4, 11).

36. For a detailed treatment of Say and the extent to which he might be called a proto-Austrian, see Sechrest 1999.

37. One approach that does seem to be without a theoretical framework is that of the influential National Bureau of Economic Research (NBER). See online at: < http://www.mises.org/story/ 958#_ftn1>.

38. Given the relative frequency with which Robbins is favorably cited by Austrians, one has to be a little perplexed by all this. Has Salsman really read so few Austrian works that he never encountered references to *The Great Depression* ?

39. Reliable data for this period is often scarce, but one researcher found that the capital/output ratio for all American manufacturing industries rose from 68.8% in 1919 to 82.9% in 1929, before falling to 74.4% in 1937. For one extremely capital-intensive industry, petroleum refining, this ratio went from 71.6% to 121.3% to 111.4% (Creamer 1954, 81–83). Here "capital" includes fixed assets, inventories, goods-in-process, and working capital. One can also look at the ratio of capital equipment to Gross National Product (Bureau of the Census 1975, Series F 1–5; 224). That was 1.89% in 1922, 2.27% in 1926, 2.37% in 1928, 2.62% in 1929, 1.19% in 1931, 0.69% in 1932, 1.08% in 1933, 1.23% in 1934, 1.99% in 1937, 1.30% in 1938, and 1.44% in 1939.

40. Notice how Salsman repeatedly mixes together prices and values. The issue at hand is whether or not those stock prices accurately reflected the underlying value of the firms. One cannot simply dismiss the controversy by *defining* corporate value as its stock price (multiplied by the number of outstanding shares, of course). Call that the current market value, but not the fundamental, or equilibrium value. If stock prices always accurately measured the true value of the firm, then there would, for example, be little motive for corporate takeovers. Takeovers usually occur because corporate "raiders" believe the stock is underpriced. That is, they believe they can buy the stock, gain a controlling interest in the firm, install a different management team, and achieve greater profits than is currently the case. Therefore, stock which they buy for, say, $50/ share will later be priced at, say, $100/share. Also, in the context of more recent events, would Salsman really want to insist that the stock of, say, Enron or WorldCom was never overpriced? That it *could not* be overpriced?

41. Specifically, he says the "average corporate bond yield fell from 7.4% at the end of 1920 to 4.9 % in early 1928" (2004a, 22). It is hard to tell where he acquired these numbers. The St. Louis Federal Reserve shows that, between December 1920

and March 1928, Moody's Baa corporate bond rate fell from 8.56% to 5.32%, while Moody's Aaa corporate bond rate fell from 6.26% to 4.46%. See online: <http://research.stlouisfed.org/fred2/data/AAA.txt> and <http://research.stlouisfed.org/fred2/data/BAA.txt>.

42. Salsman makes much of the fact that some economists call interest rates the "price of money"(2004a, 23). Those who do so are indeed confused, but Austrians are not among the confused. In fact, neither is another of Salsman's targets: Milton Friedman. Friedman (1972, 201) himself said that "the interest rate is not the price of money. The interest rate is the price of credit . . . the inverse of the price level is the price of money."

43. It is, however, consistent with the observation that the Republican Party has a long tradition of enacting protective tariffs as an essential part of its neo-mercantilist economic agenda (DiLorenzo 2001, 217–27).

44. Given that Salsman engages in this flight of fancy, it is ironic to read his solemn exhortation: "Instead of mythology, let us consult reality" (2005, 14).

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