

BOOK REVIEW

MONEY, BANKING, AND THE BUSINESS CYCLE, VOLS. I AND II

BRIAN P. SIMPSON

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INTRODUCTION

Whenever a new book on money and the business cycle from an Austrian perspective is published, the hope is that it will be another monumental contribution setting before the reader the best of monetary and business cycle theory. Alas, while Brian P. Simpson's *Money, Banking, and the Business Cycle* includes 509 pages of small dense print stretching over two volumes, such hope is unfounded. While making numerous helpful contributions to our understanding of the economic history of business cycles in the United States, the way Simpson develops his business

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cycle theory leads to more confusion than clarification. So much so that the work is ultimately disappointing. One should not turn to *Money, Banking, and the Business Cycle* to learn Austrian business cycle theory. For those looking for a modern, book-length treatment of business cycle theory from an Austrian perspective, Huerta de Soto's *Money, Bank Credit, and Economic Cycles* and Roger Garrison's *Time and Money* are still preferable.

ECONOMIC THEORY

Volume I of Simpson's work includes chapters on monetary theory, inflation, business cycle theory, and the economic history of business cycles in the United States. While ultimately disappointing, Simpson does make several positive contributions along the way.

Such is Simpson's material on money, banking, and inflation. Before jumping into business cycle theory, he rightly begins with money, because it is the one good that integrates the entire social economy. He states up front that the source of the business cycle is government generated fluctuations of the money supply, because money is the general medium of exchange. As such, it is used in all markets and money prices are the basis for economic calculation (I. p. 9). He defines money as the medium of exchange and includes in his measure of money currency, demand deposits, that portion of money market mutual funds (MMMMFs) and money market deposit accounts (MMDAs) that people use as a medium of exchange, that portion of retail sweep accounts not swept into MMDAs or MMMFs. He does not include savings accounts.

Following sound monetary theory, Simpson defines inflation in terms of money and not prices. Inflation is "an increase in the supply of money at a rate more rapid than an increase in the supply of gold or precious metal money" (I. p. 25). Of course, Simpson is here presuming a metallic monetary standard that does not presently exist.

Simpson rightly identifies the state as inflationist-in-chief. It inflates directly by creating standard money, through its central bank. The state inflates indirectly by encouraging banks to engage in fractional reserve banking through granting various privileges to commercial banks.

He properly understands that, without a change in demand to hold money, the only way for total spending in an economy to increase is for the government to increase the money supply. Contrary to Keynesian dreamers, Simpson explains that increases in government spending funded by taxes or borrowing from the non-bank public merely changes the pattern of spending. It does not alter total magnitude of spending. For total spending to increase, the state must spend more without anyone else spending less. This can happen only if government spending is ultimately funded by monetary inflation. Therefore, fiscal policy *per se* does not affect the quantity of spending in an economy, but only “who does the spending” (I. p. 38).

Simpson also provides a good refutation of the Keynesian multiplier argument alleging the economic benefits of government spending. He notes that not only do all savings get spent in an economy, but investment is the most important type of spending for economic prosperity in the long run. He likewise understands that any “scramble for liquidity” is an effect of recession, *not* the cause (I. p. 55). If we want to be rid of recessions, we do not need or want fiscal or monetary activism. The state merely needs to cease intervening in the economy, especially via monetary manipulation.

In his positive exposition of the business cycle, Simpson makes several correct general observations that agree with Austrian business cycle theory (ABCT). He makes it clear that the business cycle is created by government manipulations of the money supply. It is statist intervention that is responsible for fiat-money, fractional reserve banking, and its resulting inflation. Getting rid of government money production and intervention in monetary system and banking industry, therefore, will eliminate the business cycle. He even identifies positive reforms to eliminate the cycle such as moving to a 100 percent reserve, free market monetary and banking system. Simpson assumes it will be a gold-based system.

Simpson proves to be a generally competent defender of ABCT against several of its attackers. Rejecting one of Leland Yeager’s (1986, p. 380) criticisms of ABCT, Simpson points out that the principle of Occam’s Razor does not invalidate ABCT because the principle implies laying aside *needlessly* more complex explanations for simpler ones. If a situation calls for a complex explanation, however, then a more complex theory is warranted. The

business cycle is a complex problem with many economic facets. ABCT is the theory that best accounts for the many aspects in the simplest way.

Simpson also helpfully refutes the claim that ABCT is invalid because inflation affects short-term interest rates more than long-term interest rates. He notes that even a small decrease in long-term rates make long-run investments look more profitable. At the same time, he affirms that changes in time preference will not be disruptive and not result in a boom/bust cycle. Unfortunately, he stresses that this is so because such changes in time preference tend to be gradual. He misses the crucial point that these changes are by their nature sustainable. They do not encourage investments inconsistent with social preferences. *This is the main point.* Not that such changes are long-term as opposed to short-term. He does, however, recognize that there is a fundamental distinction to be made between interest rates changing due to changes in time preference and that due to monetary inflation.

Simpson also defends ABCT against claims that if it is valid at all, it applies only to cases where resources are already being used to their capacity, not if there are idle resources during a recession. Simpson explains that so-called unused resources are not being wasted. The overall plans of the owners may include the necessity of keeping extra on hand for contingencies, for example. He here agrees with W. H. Hutt (1977) without citing him. He further expounds on this point to successfully explain that ABCT is valid with or without fully employed resources. Here he agrees with Mises (1949, pp. 576–578).

Simpson then provides an excellent defense against the charge that ABCT is inconsistent with rational expectations. He notes that conventional definitions of rational expectations are not very good or helpful. Rational action, Simpson explains, is action based on all relevant, available information, *not* perfect information. “As long as businessmen form their expectations using reason, their expectations are rational” (I. p. 107).

With the above documented positive contributions made by Simpson in his monetary and business cycle theory, the reader of this review might wonder what’s not to like. Unfortunately, there is much. One limitation is his resorting to a strange Randian

classification system with regard to what he sees as unsupportable arguments or assertions. For instance, while he does include money market mutual funds in his definition of the money supply, he criticizes Rothbard for including savings accounts “that can be converted at par into money at any time on demand” (i.e. money substitutes) in the money supply. Simpson claims Rothbard’s inclusion is an example of “context dropping, first identified as a major logical fallacy by the novelist and philosopher Ayn Rand” (I. p. 16).

When discussing the nature of fiduciary money, Simpson asserts that fiduciary money consists of checking deposits not backed by standard money but rather “backed by debt” (I. p. 21). Such fiduciary money is issued in the form of debt to be sure, but that is not the same as being “backed” by debt. The holder of a checking account cannot exchange checking deposits for debt.

Simpson further adopts a simple monetarist, quantity theory of money approach to inflation. The simple equation he uses is $P = D/S$ (where P = the “general price level”, D = monetary spending on economic goods, and S = S of good produced and sold in the economy). He begs the question of the nature of the general price level.

As Simpson begins to explain the cause of inflation, he understandably places emphasis on spending facilitated by increases in the money supply. He concedes much to Keynesian theory, however, by drawing a straight line from more spending to higher profits, “In the long run, more money leads to more spending in the economy. More spending, in turn, leads to greater revenue and profits for business” (I. p. 33). Certainly more money leads to more spending and revenue. However, it is not clear at all that such spending necessarily leads to more profits. Profits are the difference between revenue and costs. If costs increase along with revenues, due to monetary inflation, profits do *not* increase.

Simpson explicitly defends the quantity theory’s equation of exchange as a communicator of economic information, specifically identifying Mises’s and Rothbard’s criticism of the quantity theory without citing them. Simpson argues that the equation of exchange focuses our minds on two variables that affect total spending: money supply and velocity. He says this is “extremely important

in understanding the nature of economic activity and, more specifically, the nature of the business cycle" (I. p. 46). In fact, because business cycles are the result of malinvestment which has to do with relative prices and interest rates and is *not* driven by changes in overall prices or spending, the equation of exchange tells us little to nothing about the business cycle. Despite his generally good criticism of Keynesian theory, he mistakenly indicates that Keynes and the Keynesians' solution for recession is to boost consumption spending (I. p. 46).

The most troubling weaknesses of Simpson's work, however, comes in his positive explanation of the business cycle theory. Despite the generally correct conclusions mentioned earlier, his book is simply not where one wants to turn for an explanation of ABCT.

In explaining the cause of the cycle, Simpson argues almost exclusively that it is due to an increased rate of profit due to increasing the money supply above what is expected. He says that if the money supply increases at a slow and steady pace, spending increases, but this has a minimal effect on the economy. He here focuses on aggregates in the quantity theory. A two percent increase in the money supply, for example, only causes a two percent increase in prices. As long as increases in the money supply are slow and steady, in Simpson's opinion, entrepreneurs are able to incorporate them into their plans and make adjustments consistent with the slow and steady increase in spending. This is more monetarist than Misesian. It also smacks of the New Classical money surprise-aggregate supply hypothesis in that it hinges on the money supply increasing at too great a rate for entrepreneurs to include in their expectations.

In all of this Simpson fails to see that the initial monetary injection itself produces the initial malinvestment. Malinvestments do not occur merely after entrepreneurs allegedly see profits increase due to increased spending due to the increased money supply. As F. A. Hayek noted in *Prices and Production*, the process *begins* with the increased spending of entrepreneurs due to monetary inflation via credit expansion (Hayek, 1931, pp. 241–249). Simpson also fails to recognize that decreased market interest rates will increase expected profit at the same time. So expected profit increases precisely *because* the market interest rate is artificially lowered.

Contrarily, Simpson claims that most ABCT theorists place too much emphasis on the manipulated interest rate and not nearly enough on the rate of profit, which he sees as the primary catalyst of the cycle. He seems shockingly unaware that it is not merely “most ABCT theorists” *but the very originator* of the theory who emphasized the importance of artificially low interest rates in stimulating the boom/bust cycle. Ludwig von Mises (1912, pp. 357–364), in his first explanation of the business cycle in *The Theory of Money and Credit*, cites a lowering of the interest rate due to expansion of credit via fiduciary money as the trigger that begins the inflationary boom by making various production projects appear profitable when, in fact, they are not. Mises continued to emphasize manipulated interest rates as causes of the cycle throughout his career (Mises, 1928, pp. 107–111; 1931, pp. 160–161; 1936; 1949, p. 550). In an address he made in 1931, Mises was very clear. “The interest rates are reduced through the expansion of credit, and then some businesses, which did not previously seem profitable, appear to be profitable. It is precisely the fact that such businesses are undertaken that initiates the upswing” (Mises, 1931, pp.160–161). In commenting on the Great Depression that was then in full swing, Mises explains, “The crisis from which we are now suffering is also the outcome of a credit expansion. The present crisis is the unavoidable sequel to a boom. Such a crisis necessarily follows every boom generated by the attempt to reduce the ‘natural rate of interest’ through increasing the fiduciary media” (Mises, 1931, p. 163). F. A. Hayek (1929), who won his Nobel Prize in economics partly for his development of Mises’s business cycle theory, also cited an artificially low interest rate as the catalyst for malinvestment.

Simpson’s focus on the rate of profit he claims is an advance developed by George Reisman. Simpson makes a hard distinction between the interest rate and the rate of profit and treats them as completely independent of one another, almost like Keynes’s distinction between the interest rate and the marginal efficiency of capital. In fact, however, the lower interest rate *causes* an increase in the rate of profit. An investment’s “rate of profit” is better understood as a firm’s return on equity minus the interest rate (Rothbard, 2004, pp. 509–516). As the market interest rate falls then, other things equal, the firm’s expected profit increases. *This* is what motivates malinvestment.

Simpson does recognize that the period of production and fluctuations therein are related to the business cycle. However, he asserts that the production structure can be identified with the average period of production. As a needless aside, he asserts that economic progress is due only to application of scientific method to natural phenomena and then application of that knowledge to our problems. Faith and emotions, both contrary to science evidently, represent an "abandonment of reason." Such claims are typical of faithful Randianism.

His defense of ABCT against critics likewise features a hodge-podge of good insights mentioned above weakened by muddled theory. While downplaying the importance of interest rates, he emphasizes again that "more than anything else" what affects businesses' decision making is the rate of profit (I. p. 89). "Any valid business cycle theory must recognize the primacy of the rate of profit over the interest rate" (I. p. 90). Again he seems to fail to see how the monetary interest rate affects the perceived rate of profit. He then goes on to actually explain how artificially low interest rates reduce borrowing costs and hence raise the perceived profitability of long-term investments. In so doing, he refutes his own previous claims implying a sharp independence between the market interest rate and rate of profit.

ECONOMIC HISTORY

After Simpson's muddled business cycle theory, it is refreshing to turn to his empirical work. Simpson makes a valuable contribution by providing much data illustrating ABCT in economic history. Interestingly, he does not approach the history of business cycles chronologically, but begins with the 1980s, moves forward to the 1990s into the early 2010s, then jumps back to discuss the Mississippi scheme of John Law, moves forward again to the Great Depression and then finishes with the a chapter devoted to the period from 1900 to 1965. It seems to this reviewer that there would have been better flow if the chapters were kept in chronological order. Better flow would help in comprehension.

Nevertheless, Simpson's work illustrates the virtue of identifying and handling statistics in ways that best enable rightly telling relevant history. Simpson begins by compiling a preferable statistic

accounting for aggregate spending in the economy, which he calls Gross National Revenue, which includes total sales revenue by businesses plus total wage payments in the economy. This allows for a statistic that is more gross than GDP, thus better representing aggregate spending in the production structure. At the same time Simpson's empirical work demonstrates the virtue of drilling beneath the aggregate empirical surface in order to make sense of the macroeconomic impact of government money manipulation. The more precisely we are able to define data groups within the structure of production, the more the data supports ABCT. Simpson's method begins with distinguishing between rate of return on equity, the interest rate, and the difference between the two. This is partly due to his carrying over the theoretical importance of profit expectations to his explanation of economic history.

He does confuse the issue some by equating pre-tax rate of return on equity (ROE) as the rate of profit. Thankfully, he usually includes a data set for the difference between the ROE and the interest rate. That statistic is a better measure of economic profit than ROE.

When describing the recession of the early 1980s, Simpson identifies a number of important insights illustrated in the data. He illustrates the destructive effects of reflation to combat recession. He also notes that, because inflation had been building up during the 1960s and 1970s, malinvestments were made that necessarily had to be undone regardless of whether the Federal Reserve announced to the public its intentions to slow the rate of money supply growth. Simpson argues that according to rational expectations theory, the recession of the early 1980s should have been avoided, because the Federal Reserve made announcements in the late 1970s of its intention to slow the rate of monetary inflation. Investors should have taken notice of the Fed's intention and acted to avoid a recession. The recession of the early 1980s, therefore, is contrary to rational expectations and new classical economics but verifies ABCT.

The lessons Simpson takes from his first chapter on economic history include identification of the best policies to avoid recession and to foster recovery. Because monetary inflation is the source of the inflationary boom that necessarily results in a recession, the obvious policy to avoid the business cycle is to cease inflation.

History also teaches that the best policy to speed recovery is to forgo additional intervention in the economy.

Unfortunately, Simpson's discussion of second best policies is unsatisfactory at best. It is especially hard to make sense of his call to not let the money supply fall, as if it is the job of the central bank to maintain an optimal, or at least minimum threshold, money supply.

In his chapter covering the United States from 1965 to 2012, Simpson amasses a significant number of relevant statistics to illustrate how macroeconomic history in the U.S. played out as ABCT would imply. He helpfully documents how monetary inflation precedes increases in economic profit (ROE – the interest rate), thus giving incentive for malinvestment. However, he fails to cite relevant literature that would have broadened his history,¹ and Higgs (2006) on uncertainty that would have broadened his history.

Simpson's history of John Law's Mississippi Scheme (which he rightly calls a financial scam) and the South Sea Bubble make for fascinating reading. Simpson applies elements of ABCT to these historical episodes, arguing that monetary inflation fueled bubbles in capital markets that necessarily burst, resulting in severe financial distress for many. His discussion of Law's Mississippi Scheme is particularly engaging and enlightening, marred only by a strange and unnecessary Randian attack on religion.

Simpson provides the reader a detailed exposition of the macroeconomic history of the Great Depression, embracing the traditional Austrian explanation. Inflationary credit expansion during the 1920s fueled an inflationary boom that turned toward recession in 1929 and that turned into the Great Depression as succeeding Presidents Hoover and Roosevelt increasingly intervened in the economy, hampering the necessary readjustment process. Simpson provides a long list of interventions both Hoover and Roosevelt made that significantly forestalled recovery. As in earlier chapters, however, he stumbles into making a strange charge, citing both collectivism and altruism as the ideological sources of their destructive interventionist policies. Collectivism

¹ For recent economic history literature that would have complemented Simpson's economic history, see Callahan and Garrison (2003), Cochran (2011), Ravier and Lewin (2012), Salerno (2012), and Woods (2010).

perhaps, but altruism? Again with the needless and unhelpful Randian categories.

In his chapter documenting the macroeconomic history of the US from 1900 to 1965, Simpson again makes good use of a large quantity of data to illustrate the ABCT. He includes a particularly excellent discussion of the economic impact of World War II, successfully explaining why wartime prosperity and the claim that the war got us out of the Great Depression are illusory. His only stumble is his unfortunate buying into the monetarist notion that a decrease in money supply in 1936–1937 led to recession in 1938, prolonging the Great Depression.

CRITIQUE OF ALTERNATIVE BUSINESS CYCLE THEORIES

Simpson begins the second volume of his work critiquing Keynesian and Real Business Cycle Theory explanations of business cycle theories. Beginning with Keynesian underconsumption theory, he points out that those who fret about a lack of consumption fail to recognize that shifts from consumption to investment results not in a decrease in total spending, but merely in a shift in spending. Likewise, reallocating spending from labor to spending on capital goods will not even result in decline in real wages in the long run, due to increases in productivity which increase real purchasing power of wages via increased output.

Simpson helpfully reminds us that not even hoarding causes recession. He notes that hoarding may often be an effect of a business cycle, but never the cause. In fact, hoarding is beneficial to the economy because it corrects previous errors by people who became too illiquid during the boom. He also provides an excellent exposition and refutation of Keynes's claim that it is normal for free markets to be in chronic depressive states due to wild swings in investment spending driven by animal spirits.

Simpson also makes a good refutation of the Keynesian "sticky" wages and prices theory of the business cycle. He correctly notes that, contrary to conventional Keynesian wisdom, flexibility of wages can be negotiated into contracts on the one hand, while on the other actual inflexibility in wages does not necessarily result in negative economic consequences.

Simpson also provides the reader with an excellent refutation of New Keynesian efficiency wage theory. He reminds us that if paying workers higher than market “efficiency wages” actually provides efficiency gains, lower production costs offset the higher wages. If they do not, employers cannot pay the higher wages. If such efficiencies do justify higher wages, however, the efficiency wage is merely the market wage. In this he agrees with Don Bellante (1994).

Simpson then continues with a variation on his main theme by explaining how government intervention is the leading cause of labor market inflexibility and unemployment. Government subsidies such as unemployment benefits can allow unemployed workers to remain out of work long enough for their skills to atrophy. All in all, Simpson concludes, Keynesians focus too much on “sticky wages” and not enough on volatility in the money supply and spending.

Simpson likewise makes excellent use of empirical evidence countering sticky wage and price theory. He documents how Alan Blinder’s survey of businesses about their factor-pricing behavior does anything but verify sticky-wage theory (II. p. 69–77). However, it must be said that a lot of Simpson’s argument rides on just one survey. Nevertheless, Simpson argues that sticky price theorists have only identified one minor piece of empirical support—lagging price changes—and he notes that Keynesians do not recognize that such a lag occurs due to accelerated changes in the money supply. Additionally, many of the characteristics of a “sticky wage” theory of the business cycle are inconsistent with observed features of the cycle.

Simpson’s generally devastating critique of Keynesian theories is marred by a couple of errors, however. Surprisingly, while refuting the claim that recessions are the result of insufficient aggregate demand via a lack of consumption spending, he nevertheless identifies the cause of recession as “a decline, less rapid increase, or less rapid acceleration in spending” (II. p. 17). This is not correct, as long as prices are flexible downward—as they are in a free society. Additionally, while criticizing the neoclassical model of perfect competition, Simpson embraces a neoclassical objective cost theory of supply, claiming that firms are not price takers because they set their price based on their costs of production.

One of Simpson's best chapters is his excellent and somewhat detailed critique of Real Business Cycle Theory (RBCT). He criticizes RBCT economists' methods, noting that merely to mimic an empirical phenomenon does not offer an explanation for why said phenomenon occurs. In fact the theory of fluctuations in RBCT is rather sketchy because it does *not* identify causal factors involved with the business cycle. Explaining the contraction phase of the bust by alluding to technological change is a bit rich for Simpson. The same goes for asserting that changes in fad and fashions can result in the boom/bust cycle.

One point of agreement between Simpson and RBCT is the recognition that government intervention plays a role in recession. However, while RBCT sees changes in regulation as a potential cause of business cycles, Simpson notes that, while non-monetary government intervention might make a recession more severe, it is not the cause of the cycle.

CURING THE BUSINESS CYCLE

Simpson concludes his work with several chapters that speak to how society can cure the business cycle by keeping the state out of the way. He properly identifies government's desire to increase spending without taxes as the main reason for fiat paper money. He likewise understands the unsoundness and instability of fractional-reserve system. He adopts Rothbard's view in *The Mystery of Banking* that free banking would not lead to wild fractional reserve banking, but oddly without citing Rothbard.

Simpson effectively critiques George Selgin's claim that increases in money supply necessarily increases savings. He notes that changed asset composition is not the same as increased savings.

Simpson also explains that banks are *not* counter cyclical, but are in fact pro-cyclical. He recognizes that if the supply of goods increase, so the price of goods falls, people can buy more goods with the same money, there is not a "needs of trade" necessitating an increased money supply.

Unfortunately, Simpson argues for a moral right of banks to issue fiduciary money. He is here contrary to Rothbard, again without citing Rothbard. He explicitly criticizes Heurta de Soto primarily.

He does so partly because he views increased cash holdings as an increase in savings. The problems of fractional reserve banking, for Simpson, are philosophical not ethical. Simpson dislikes fractional reserve banking, not because it is fraudulent, but because the practice is “philosophically unsound.” A glaring weakness is his failure to interact and respond to several relatively recent criticisms of the so-called free banking literature (Bagus and Howden, 2010, 2011; Howden, 2011, pp. 121–128; Hülsmann, 1996, 2003)

Simpson then proceeds with his understanding of what a free market in money and banking would look like, how it would perform, and what effects it would have on the social economy. To forestall the canard that people happily and voluntarily use our current statist, inflationist system, he correctly notes that societies did not, in fact, voluntarily move away from gold, but were forced off by their respective governments. His discussion includes the sound reminder that money functioning as unit of account is dependent upon and linked to money *being* a general medium of exchange.

Simpson’s description of the distinctive characteristics of a free banking regime are the common ones. It would be a banking industry unencumbered by government regulations, and fractional reserve banking would be allowed. Simpson would require that the government only be allowed to deposit its own money in its own banks, so as to remove government completely from the monetary system. For this system to work, Simpson makes what seems to be a naïve suggestion—the institutional stipulations for free banking must be enshrined in a constitution. We have a constitution now that does not mention a Congressional power to charter banks, but this has not stopped the government from socializing money production and cartelizing the banking industry through the Federal Reserve.

When explaining the performance of a free banking regime, he reaches basically the same conclusions as Rothbard in *The Mystery of Banking*, but does not cite Rothbard. For example, Simpson argues that in order for people to be willing to hold a particular bank’s bank notes, said bank would have to develop reputation for being conservative and sound in its practices. This fact among others would constrain banks in a free market from wild, profligate inflation. In fact, it is argued that the constraints on inflation in a free market setting are definite enough to result in banks operating at or very near 100 percent reserves.

Criticizing the divorce of the unit of account function from money *being* the medium of exchange, Simpson lapses into Randian quirkiness again. To do so is to be guilty of “context dropping” and the “fallacy of the stolen concept” (II. p. 181).

Simpson then provides some helpful general conclusions from various episodes in the history of money and banking. He identifies correlation between government intervention in the banking industry and decreases in reserve ratios. He also reports the extent of government intervention in many so-called “free banking” periods. However, in his account of the history of banking, he seems to want it both ways on issues of limited liability and whether fractional reserve banking is fraudulent, claiming that banking is “one of the easiest industries in which to engage in fraud because it is easy for bankers to secretly lend reserves that they are contractually obligated to keep on hand” (II. p. 216).

Simpson’s preferred monetary regime would be a free market, 100 percent reserve gold standard. Simpson provides a generally good explanation of the benefits of such a system. It would be much more stable than government paper and fractional reserve money. Such stability would help entrepreneurs improve business forecasting using economic calculation. One hundred percent gold money also would keep unwise or bad loans of one entrepreneur from spreading as a contagion to the rest of the economy, because bank deposits are never at risk.

A 100 percent gold dollar additionally would prevent non-productive consumption because people would be unable to consume without producing via government fiat monetary inflation. Simpson here echoes the argument of James Mill in his *Commerce Defended*. Governments would not be able to borrow as easily as they now do. Government debt, therefore, would not be perceived as “risk free” as it now is, because the state has no ability to pay it off via monetization.

He also seems to contradict his earlier staunch defense of the ethics of fractional reserve banking by implying that a 100 percent gold standard prevents fraud. “Fractional-reserve banking is an attempt to cheat reality because it is a situation in which people attempt to have their money and lend it too” (II. p. 232). Of course, “cheating reality” could allude to philosophical inconsistency,

but cheating implies fraud, which Simpson strongly denies in an earlier chapter.

Simpson does provide excellent refutations of attacks on the gold standard. He reminds us, for example, that if output doubles and prices are cut in half, entrepreneurs have the same ability to reap profits. Such a change is not recessionary. He also notes that if fiat money was socially preferable, we would expect that it would have arisen out of a free society. In fact, commodity money did.

Unfortunately Simpson includes in his defense of a 100 percent gold standard several weaknesses at various points in his argument. When asserting that gold is deflation proof, for example, he says that it cannot cease to be once it comes into existence. With regard to gold's impact on the money supply, what matters is not the quantity of gold in existence, but how much existing gold is used as money. Gold can be changed from the form of monetary gold into use as a commodity. In which case, the money supply would decrease.

Simpson also claims that commodity money is "a stable and easily understandable measure of value" (II. p. 221). In fact, Mengerian economists know that value is subjective and not objectively measurable, even by money prices. As Mises (1912, pp. 38–45; 1922, p. 99) pointed out over a century ago, prices are manifestations of value, not measures of value. Additionally, overall prices are never "stable," so exchange value of money is never absolutely stable (Mises, 1928, p. 72).

Simpson sounds rather market-monetarist when defending some aspects of the gold standard. He argues that falling prices due to increases in production do not lead to unprofitability and recession, *as long as the quantity of money and spending increases*. "The key to increasing profitability is that the amount of spending increases" (II. p. 222). Increases both in the money supply and spending contribute to increases in the profit rate, he claims, because additional revenues are generated for entrepreneurs. Because, in his mind, spending increases are what leads to increased profitability, Simpson is likewise fixated on not allowing spending to fall. "The key is to make sure the money supply and spending to not fall, which is what a 100 percent reserve gold standard does" (II. p. 223).

As already mentioned above, what matters for profitability is not the volume of spending or revenues *per se*, but the gap between

the price of products and the sum of the prices of factors used to produce those products. This gap can continue to be positive even if the total quantity of spending falls. What matters is entrepreneurial foresight and not whether spending increases or decreases. Spending could in fact decrease in a 100 percent gold standard, but would not be a problem even if it does.

Simpson also lapses into imprecise usage of the terms *objective* and *subjective* when asserting that gold has objective value. He means by *objective* that value is based on the rational assessment by people of the ability of gold to increase their satisfaction. He cites industrial and ornamental use of gold as the source of gold's objective value. He contrasts the objective value of gold with a subjective value of fiat money. He says the value of fiat money is arbitrary and dependent on the designation by the state of what a paper dollar is worth. This attempt to express the contrast between the value of commodity money and that of fiat money is clumsy at best, but more likely misleading and confusing.

His final chapter providing his plan for transitioning from our current statist system to a free market in money and banking is likewise a mixture of good and bad. His plan for moving to a gold standard is explicitly similar to that of George Reisman and Murray Rothbard. Along the way, Simpson follows Salerno in providing a good analysis and critique of pseudo gold standard schemes. He is, unfortunately, a little easy on banksters who do in fact work to perpetuate the current system to happily increase their own wealth via fractional reserve banking.

CONCLUSION

This reviewer had hoped that Simpson's *Money, Banking, and the Business Cycle* would be the next brilliant contribution to our understanding of Austrian business cycle theory and how modern banking practice help generate inflationary booms and recessions. Alas, Simpson's work is ultimately disappointing. While making numerous helpful contributions related to economic history, Simpson's exposition of business cycle theory misleads rather than clarifies. Do not look to Simpson if you desire to learn Austrian business cycle theory. For those desiring a modern, book-length treatment of business cycle theory from an Austrian perspective,

Huerta de Soto's *Money, Bank Credit, and Economic Cycles* is still the gold standard.

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