

America's Great Depression Notes, Ch. 3, Part 1

Alternative Explanations of Depression: A Critique

- Some economists admit ABCT explains some cycles, but that there might be other theories to explain other types of cycles
 - Rothbard says this is erroneous
 - Government action may precipitate all kinds of problems, but the cyclical boom-bust cycles all stem from the same cause: credit expansion
 - Rothbard clarifies his word for economic slumps with proximate, obvious causes (e.g. natural disasters): “crises” – Not the same as a boom-bust cycle
- General Overproduction Theory
 - Hypothetical crisis marked by unsold goods and unused capacity
 - Rothbard: There is no such thing as “general” overproduction—that’s just economic growth in most cases, has no reason to cause depression
 - Even in deflation times, money could be used to buy up “overproduced” goods
 - Businessmen holding their prices up are just “investing” in inventory
 - Why have selling prices fallen below the costs of production?
 - Entrepreneurs are supposed to handle this
 - They’re getting bad signals, causing this cluster of errors
 - Overproduction can only happen in *specific* goods/industries, others underproduce
- Underconsumption Theory
- Theory: Either by too much investm’t or too much income to upper-income groups, consumer demand is insufficient to buy what has been produced
 - Rothbard: Consumption levels have a minimum—can’t stop consuming entirely
 - If consumption falls for an extended period, prices should be able to adjust
 - It is the entrepreneur’s duty to predict consumer demand and move capital accordingly
 - Underconsumption theory fails to explain this cluster of errors
 - Productivity only expands when people want more consumption
 - Therefore, production cannot outrun consumer demand in general, for an extended period
- Alternate theory: Alleged shift to profits and the rich?
 - Rothbard: No, on the margins, the rich might treat extra income as a windfall and consume it
 - There is not necessarily a shift from poor to rich during the boom
 - The rich and entrepreneurs must also consume
 - Savings are analogous to the demand for producers’ goods, such goods as necessary to sustain the structure of production
 - To sustain a higher standard of living, must permanently lengthen and add to structure of production
 - Gross inventory growth doesn’t appear in GDP/GNP
 - Savings must increase to improve the standard of living sustainably—savings aren’t “wasted”
- Alternate theory: Expanding production depresses the economy because it causes prices to fall
 - Rothbard: All unit costs will fall, so profitability is not injured
 - Prices and wages should both fall as productivity rises (wages less so than goods)
 - Inflating the money supply to fight this natural deflation initiates the boom-bust cycle
 - If underconsumption was valid, consumers’ goods industries would depress more and have surpluses, but this is not what we see

- The Acceleration Principle
- Attempt by underconsumptionists to explain fluctuations in producers' goods' prices
- Theory: Consumer demand exerts a leverage effect on demand for producers' goods
- Read carefully the hypothetical scenario on pages 60-61
 - Rothbard: Tissue of fallacies
 - Assumes massive, consistent expansion for previous decade
 - Assumes machines bought one at a time
 - Irrationally extends from single firm to whole economy
 - The market can handle worse "fluctuations" from new firms buying many machines at once, so it can handle these smaller fluctuations
 - W.H. Hutt breaks down a major fallacy
 - "1 year" period is arbitrary as would be "1 week;" highly unrealistic
 - Proper period is length of serviceability of machines (10 years in example)
 - In that timeframe, consumer and producer demand grow at the same rate; no leverage actually occurs
 - Other assumptions: no substitution, more or less intensive working of other factors, finely divisible capital...
 - FATAL FLAW: No mention of price system or entrepreneurship
 - Hopelessly mechanistic
 - As consumer demand rises, so will prices
 - Leads to signals to entrepreneurs and extra profits for machine holders
 - Recall 7-year locust example—entrepreneurs can handle this problem!
 - What funds this 20% increase in demand? Something else has to fall or investment must!