Depression, War, and Cold War

Robert Higgs

Oxford, United Kingdom: Oxford University Press, 2006 (221 pages)

Robert Higgs describes *Depression, War, and Cold War* as an interim report on work related to his 1987 classic, *Crisis and Leviathan*. *Depression* includes ten previously published articles on the military-industrial-congressional complex (MICC) newly revised for this book. The brief introduction by Higgs provides scholarly context while revealing the primary purpose behind the collection: "The first five chapters … constitute essential pieces of one big puzzle, offering at once a new view of the prolongation of the Depression, … the nature of the war production 'boom,' and … the transition from wartime economy to postwar civilian prosperity—all within a single interpretive framework" (xi). Higgs offers this framework as a replacement for "the old (and still widely accepted) view of how 'the war got the economy out of the depression' …" (xi). The importance of Higgs' single interpretive framework may overshadow the contributions of later chapters that contain fewer surprises of the magnitude found in the first half of the collection. The usual scarcity of space limits further comment on those latter chapters other than to say that they deal with the contribution of the MICC to political corruption, rent seeking, and the weakening of national defense.

Regarding the single interpretive framework developed in the first five chapters, Higgs explains that he is not providing a substitute for the well-known macromonetary interpretation of the Depression and the eventual recovery. Nevertheless, Higgs considers the macromonetary interpretation to be insufficient to explain events beginning in the mid-1930s because it fails to recognize the profound impact that government policy had on the expectations of investors and other decision-makers. Certainly Higgs rejects the Keynesian view that dramatic war-time growth in government spending finally brought the economy out of the Depression, and that postwar consumers who cashed in war bonds and vented their pent up demand prevented the stagnation anticipated by many government officials and economists.

The heart of Higgs' framework is the regime uncertainty hypothesis introduced in chapter 1. Higgs argues that government policies pursued during the Second New Deal (1935–1940) created severe regime uncertainty and quashed private investment spending. Drawing support from Benjamin Anderson and Joseph Schumpeter, Higgs points to the impact these polices had on both actual and perceived threats to private property rights and free enterprise (10–12). Higgs notes that in the late 1930s investors and businessmen wondered whether some form of totalitarianism that would confiscate privately held capital and other property was just around the corner. During this period, legislation at the state and national levels reflected an antibusiness bias. The Supreme Court's shift away from substantive due process also heightened concerns over the security of private property (12–13). Higgs uses polling data collected before, during, and after the war to support his regime uncertainty hypothesis. He explains that before the war businessmen and the general public held largely negative opinions regarding the effect of government

intervention in the economy and the effect of government actions on business confidence. Such views could substantially depress investment and other forms of risk-taking and lead to poor economic performance (21–22).

In the second chapter, Higgs further develops the regime uncertainty hypothesis noting that from the beginning of the rearmament program in 1940, private business was reluctant to cooperate for fear that their property rights would be forfeited. Higgs identifies the origins of the MICC with the steps taken to protect defense contractors from risks associated with expanding wartime investments and production. The regime uncertainty created by government in the 1930s had come back to haunt the antibusiness elements in the Roosevelt administration. Short of totalitarianism, the price of inducing businesses to cooperate with rearmament was the drastic reduction, if not outright elimination, of risks for defense contractors (56). Higgs notes that while historians have long identified the creation of the MICC with World War II, they have not recognized that "the essential foundations of the modern military-industrial complex were laid … [before] the Japanese attack on Pearl Harbor" (55). The timing is important because it means that the mechanisms of the MICC were already in place before Roosevelt was handed virtually complete control over the economy by Congress and the Supreme Court (55).

In chapter 3, Higgs addresses the widespread belief that the war ended the Depression through an infusion of spending and the Keynesian multiplier effect, and that with wartime living standards "Americans never had it so good" (68). Higgs cites several prestigious economists who reject national income estimates for wartime economies operating under a command system (67). He also argues persuasively that living standards simply cannot improve significantly when 40 percent of the labor force is producing goods that are neither consumer goods nor capital goods that would later be used to produce consumer goods (64). According to Higgs, only when this "residuum" of the labor force dropped to 11.5 percent in 1946 and to 9.1 percent in 1947 was there a return to "genuine prosperity" (63–64). There is also an unexpected twist in Higgs' explanation of postwar events: It turns out that the *perception* of gains in material well-being affected people's expectations and reinforced the real recovery of the economy after the war. It was in this sense that the war "recreated the possibility of genuine economic recovery" (74–75).

Before introducing the last piece of his puzzle, Higgs pauses in chapter 4 to critique the popular view that socialization of investment during the war contributed to the macroeconomic stability (81–82). He explains, "previous analysts have failed to take fully into account the incomparability of capital formation undertaken by private entrepreneurs and capital formation undertaken by government officials …" (83). This is familiar ground to students of Mises and Hayek, and Higgs draws on their work to support his claim that the socialization of investment allowed the military-industrial complex to win the war but achieved nothing beyond that (96). This is but a part of Higgs' theoretical and empirical argument against the idea that the massive capital formation directed through the socialization of investment contributed in any way to the growth of the economy or to the postwar material standard of living.

The final piece of Higgs' puzzle is presented in chapter 5. He challenges the orthodox story of a postwar economy saved from depression by consumers who sell their war bonds and release their "pent up demand" (101–2). Higgs notes that the data on real GDP for 1946 indicates a decrease of 20.6 percent in a single year. His point is not that real GDP actually fell by that amount, but rather that the myth of wartime prosperity is based on the same badly distorted income statistics. The national income accounting system was simply not capable of dealing with the measurement problems inherent in the restructuring of the economy back and forth between peacetime and war (102–5). Thus, there was neither a wartime boom nor a sharp slump immediately afterward. Higgs agrees that the late 1940s was a period of strong growth, but he rejects the traditional explanation of this postwar miracle.

Contrary to widely accepted explanations of postwar demand, Higgs argues that individuals did not increase their spending by selling off liquid assets, nor did their desire to hold money balances drastically decrease (105–7). Instead, increased household spending reflected increasing incomes and a reduced but still positive savings rate. This boost in consumer demand was reinforced by an investment boom without which robust economic growth could not have been maintained. At this point, Higgs' interpretive framework shows itself to be as powerful in dealing with the postwar period as it was in dealing with the late 1930s and the war years. The postwar miracle is a result of the reversal of regime uncertainty brought about by forces that conform to his interpretive framework. Rather than being depressed by regime uncertainty, positive expectations contributed to the quadrupling of investment between 1945 and 1947. Among the factors promoting positive expectations were the reduction in corporate taxes, the replacement of early New Dealers in the administration with persons more sympathetic to business, the moderation of wage expectations, and the transition away from central planning. This is the final piece of the puzzle, solved incrementally through the preceding chapters, and it completes Higgs' new view of economic events from the second New Deal to the postwar boom.

Higgs provides a surprisingly incisive response to the broad range of questions that accompany efforts to explain this very intractable part of our economic history. Without doubt, this is the chief contribution of *Depression*, a contribution that will no doubt become more accessible when there is sufficient time to present these findings in a different format. Higgs' interpretive framework presents key challenges to both the macromonetary and Keynesian explanations of the American experience in the era of depression and world war. We look forward to future efforts by Robert Higgs to refine and develop his interpretive framework and to the exchange of ideas that it will no doubt promote among scholars in a number of fields.

—Andrew W. Foshee (e-mail: andfoshee@suddenlink.net)
McNeese State University, Lake Charles, Louisiana