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The Great Depression Was Ended by the End of World War II, Not the Start of It

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A common fallacy is that the Great Depression was ended by the explosive spending of World War II. But World War II actually institutionalized the sharp decline in the standard of living caused by the Depression. The Depression was actually ended, and prosperity restored, by the sharp *reductions* in spending, taxes and regulation at the end of World War II, exactly contrary to the analysis of Keynesian so-called economists.

True, unemployment did decline at the start of World War II. But that was a statistical residue of sending millions of young American men to fight and die in the war. There are better ways to reduce unemployment, as was shown after the war.

Statistics showed a rise in GDP during the war. But that just reflects misdefined statistical analysis. The military guns, tanks, ships, and planes produced and counted as showing rising GDP did not reflect improved standards of living for working people, or anyone else. Yes, they did win the war, and that victory was a social good, just as removing Saddam Hussein from power was a social good. But these were not economic goods and services, and should not be counted as such.

The sale prices of goods and services sold in voluntary market transactions reflects the true value of the goods and services produced, because they reflect what consumers are willing to pay for them, and so reflect the benefit that consumers see in them. But the same voluntary market transactions where consumers are spending their own hard earned money were not involved in the government's acquisition of the military guns, tanks, ships and planes produced during World War II. The *cost* of all that military materiel was simply added to GDP, as if it reflected increased production. But would not a better measure of the economic value of that military materiel, and of any coerced government transaction, be to *subtract* the cost of that production from GDP, rather than adding it?

Perhaps this economic reality can be seen better in other military conflicts. Did the American Civil War reflect a time of soaring economic prosperity for America, when both the South and the North were producing weapons of as much mass destruction for Americans as was feasible at the time? What about the cost of the Mexican-American War in the 1840s? Did the cost of the

Vietnam War represent a net addition to, or a net subtraction from, American GDP? Or the cost of the most recent wars in Iraq and Afghanistan?

I am not a pacifist who thinks defense spending has no value. But that value cannot be measured the same as consumer or productive goods and services that do increase the standard of living for working people and their families, and are purchased through voluntary market transactions.

World War II institutionalized the falling standards of living of the Depression through wage and price controls, and extensive rationing of consumer goods and services. The economic deprivation, and reduced standards of living, continued, although people perceived it was now for a good cause.

But increased government spending does nothing to create economic recovery, growth and prosperity. That is because the money to finance that increased government spending is drained from the private sector, either through increased taxes, or increased borrowing. That entire transaction involves a net drag on the economy. Increased taxes to finance the increased spending involve counterproductive incentives that reduce production and growth. Increased government borrowing drains investment capital from productive activities in the private sector and reallocates it to non-productive government consumption.

There can never be inadequate demand for any good or service in a free market economy, which is the problem Keynesian witch doctors think they are solving. If demand for any good or service is insufficient to buy up all the available supply, the price for the good or service will decline, increasing demand and reducing supply, until they are equal.

This was all further demonstrated by the end of World War II. As George Gilder explains in his brilliant, recent, pathbreaking book, *Knowledge and Power: The Information Theory of Capitalism and How It Is Revolutionizing Our World*,

"After World War II, when ten million demobilized servicemen returned to an economy that had to be converted from a garrison state to civilian needs, economists steeled themselves for a renewed depression. A sweeping Republican victory in the Congressional election of 1946, however, brought an end to the wartime government-planning regime [overregulation]. Dropping from 42 percent of GDP to 14 percent, government spending plummeted by a total of 61 percent between 1945 and 1947. One hundred fifty thousand government regulators were laid off, along with perhaps a million other civilian employees of government. The War Production Board, the War Labor Board, and the Office of Price Administration were dismantled [deregulation]."

Gilder explains the great debate at the time,

"Every Keynesian economist confidently predicted doom. Sounding exactly like his future student Paul Krugman, who would beg Obama for trillions in additional 'stimulus' spending, Paul Samuelson in 1945 prophesied 'the greatest period of unemployment and dislocation any economy has ever faced.' Arnold Kling of the Cato Institute has observed that 'as a percentage of GDP the decrease in government purchases was larger than would result from the total elimination of government today.' As Paul Krugman points out, nominal GDP, as measured by economists, did drop a record 20.6 percent in 1946 when government spending plummeted."

But that drop was just an artifact of the government's definition of GDP to include its own spending. Gilder, however, explained what actually happened,

"But a drop in government spending after a war does not depress creativity; it unleashes it. Judging the public sector contribution by its cost is the great error of Keynesian economics….*the Great Depression, which had continued through the war disguised by price controls and necessary defense spending, at last came to an end. Economic growth surged by 10 percent over two years and the civilian labor force expanded by seven million workers….[T]he private sector…launch[ed] a ten-year boom despite self-defeating tax rates on investors as high as 91 percent. The Republican Congress compensated for the high rates by introducing joint returns, effectively cutting taxes in half for intact families. Corporate taxes dropped drastically, and the tax burden, measured by government spending, fell more dramatically than at any other time in American history. Low inflation and privatization led to a resurgence of large manufacturing corporations*….[Emphasis added for low logic voters].

By 1948, the unemployment rate was 4.0% or less every month for the entire year. For most of 1952 and 1953, unemployment was 3.0% or less. Today, rabid leftists bloodthirsty to suck on other people's money worship the economic glory days of the 1950s, with its 91% top income tax rate, the boom actually ushered in by the greatest reduction in government spending in world history. But still Krugman sings daily from his same frayed Keynesian hymnal, with the broken spine and yellowed pages falling out, grinning with what he thinks is his transparent genius in repeating over and over the long proven wrong, cutting edge ideas of almost a century ago.

It was the last great Democrat President, John F. Kennedy, who put an end to the socialist tax policy, campaigning on cutting income tax rates across the board by nearly 25%, which reduced the top income tax rate from 91% to 70%. His tax cut was enacted in 1964, after his tragic assassination. The next year, economic growth soared by 50%, and *income tax revenues* ***increased*** *by 41%!* Starting in December, 1965, the unemployment rate stayed at or below 4.0% *for the next 4 years! U.S. News and World Report* exclaimed, "The unusual budget spectacle of sharply rising revenues following the biggest tax cut in history is beginning to astonish even those who pushed hardest for tax cuts in the first place."

The bipartisan troika of Nixon, Ford and Carter trashed the American economy in the 1970s, with stagflation automatically increasing effective tax rates every year. Reagan tracked in Kennedy's footsteps with the most sweeping tax rate cuts in world history, following another 25% rate cut for everyone with the 1986 bipartisan tax reform, together reducing the top income tax rate from 70% all way down to 28%. That combined with his (domestic discretionary) spending cuts, deregulation, and strong dollar monetary policy produced the greatest economic boom in world history.

The boom lasted for 25 years, from 1982 to 2007, what Art Laffer and Steve Moore rightly called in their 2008 book, *The End of Prosperity,* "the greatest period of wealth creation in the history of the planet." In the first 7 years alone, the real economy grew by one third, which was the equivalent of adding the entire economy of West Germany, the third largest in the world at the time, to the U.S. economy. Newt Gingrich and his Republican Congress added further to the tax cuts, restrained spending, and deregulation in the 1990s to keep the boom going. That was followed by the further Bush tax cuts in 2001 and 2003, which brought the unemployment rate back down to 4.4% in December, 2006, March, 2007, and May, 2007. Those unemployment rates will never be seen again, until some time after Air Force One departs to return Obama to his previous career as a street agitator. Steve Forbes reports that even in the last 5 years of the Reagan boom, from year-end 2002 to year-end 2007, American economic growth was equivalent to adding the entire economy of China to the American economy.

Unfortunately, Bush's Republicans lost sight of Reagan's domestic spending restraint and strong dollar monetary policies, and even maintained the overregulation of housing finance, so that by 2008, the Reagan Long Boom was over. Today, Obama's Democrat Progressives argue that every pro-growth economic policy – tax rate cuts, spending cuts, deregulation, and strong dollar monetary policy – is contractionary. Your average illegal alien understands America better than that. I say keep the illegal aliens, and deport the Progressives.