<u>Is the Business Cycle Really Dead?</u>

Remarks of George W. Mitchell

Member, Board of Governors of the Federal Reserve System

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Smallpox is still alive as a killer but only to those who don't get vaccinated. The forces of law and order do not eliminate every trespass of person or property but they do hold such transgressions to a tolerable level in our society. I would hope, therefore, that in considering our proposition you would regard defanging of the business cycle as synonomous with "really" dead.

The second restatement of the proposition is to make it somewhat more precise. I simply want to make sure we are confining our attention to economic fluctuations that arise from the nature of our system, with its high degree of economic freedom. These have been /observed as a somewhat periodic tendency for private expenditures on inventory and fixed investment to surge and ebb in some complex rhythm--not fully understood--and to impart to the whole economy through a succession of impulses--secondary effects that first slow the pace of economic growth and later lead to contraction. The contraction continues until countering forces appear, usually as pervasive understocking and more attractive investment opportunities in light of the then current costs of plant and equipment and prospective demands for products.

An enormous volume of empirical evidence has been put together to show how these cyclical fluctuations have occurred in the past. And these studies have been accompanied by much theoretical speculation on why such fluctuations took place. One strain of speculation is that a capitalistic economic system will destroy itself because business cycles are not only inevitable but inevitably worse. Was Karl Marx right? Are those who now contend implicitly or explicitly that the business cycle is inherent in the capitalistic system right if he was wrong?

Before we examine the evidence or the argument on the inevitability of business cycles we must make clear that the economic consequences of Government action can and do cause booms and depressions that have nothing to do with the business cycle. The economic dislocation caused by total war (World War II) or just war (World War I) is enough to set into motion forces to which the economy may still be reacting long after hostilities are over. I am not going to argue today that wars are "really dead" as well as business cycles no matter how strongly I might be so persuaded. Consequently, the fluctuations that emerge from wartime dislocations and excesses are off limits in my discussion. It is also true that Government policies far removed from any war or threat of war may lead or contribute to economic fluctuation--these phenomena, too, are off limits in my discussion.

What is the evidence we can examine to satisfy ourselves that business cycles are something we have to endure or can discard?

The best empirical evidence is from our own business experience, i.e., the postwar cyclical fluctuations. These have been mild and short. The earlier ones of 1948-49 and 1953-54 were clearly aggravated by wartime excesses and dislocations. Most recently, since 1961, we have had four years of sustained expansion--an unprecedented performance for an economy unstimulated by war demand, or after-war shortages. This evidence is impressive and breeds confidence in our ability to forestall or moderate the cycle but it does not prove that recession will not have begun by May 1965.

No matter how favorably one views the post-World War II experience the specter of the terrible depression of the Thirties remains. Can that happen again? It was not a typical cyclical phenomena though it began as one. The severity of that depression is chargeable to a progressive collapse of confidence in our credit structure followed by inadequate and tardy public policies to deal with a desperate situation.

But the lessons of the past do not, in my judgment, really answer our question one way or the other. We must deal with the issue analytically and rest our judgment on the soundness of that analysis. If we know what caused the business cycle we can make a judgment as to whether the cause can be removed or neutralized.

There are many theories about the business cycle. One of the earliest, held by W. S. Jevons and H. L. Moore, found cosmic influences to be the ultimate culprit. Through the effect of sun spots on weather conditions which, in turn, affected agricultural output in the rurally dominated economies cyclic disturbances were transmitted to the whole economy.

Drawing upon more recent theories there is one that holds the Federal Reserve System plays a leading causative role in present day fluctuations. The argument runs that by making ill-timed and irregular additions to the money supply the Federal Reserve sets in motion forces emerging as overstimulative or recessive in the economy generally some 16 to 22 months later.

My own judgment about the cycle is that the forces generating instability, and often thought to be inherent to the capitalistic economy, are mainly imperfections of knowledge and understanding with respect to inventory and capital good investment. How pervasive is this problem?

By sectoring GNP into cyclical and noncyclical components we find that personal consumption expenditures for nondurable goods and services, State and local purchases, and Federal expenditures in peace time are overwhelmingly noncyclical. The cyclically variable elements in our economy are consumer expenditure for durable goods, residential construction, business fixed investment, business inventory investment and net exports. In a period of sustained expansion these latter sectors constitute about 25 per cent of GNP.

Among the sectors, inventory investment has been the most prominent destabilizing influence. There are many reasons for spurting inventory accumulation: expectations of price increases; anticipated shortages of supply; erroneous estimates of prospective demand; even inadequate knowledge of existing inventories.

Modern methods of inventory management and better estimates of prospective demand, based on relatively stable demographic characteristics and growth patterns have vastly improved the capacity of business to keep its inventory position in a much more stable relationship to sales. Even today under the cloud of uncertainty with respect to future steel supplies the secondary effects of an anticipated turnaround in steel output may well be confined to the areas in which steel making is a predominant factor.

While inventory fluctuations are the most obvious causes of economic change, their impact is shortly spent unless they trigger or bring to light the vulnerability of other economic sectors to even the slightest faltering in the rate of expansion. At such a point the sustainability of the system will depend on the soundness of the long range market forecasts recently made and on which plant expansion and modernization and the commercial and residential construction has taken place. I have no doubt that we all can cite cases of over-investment in the past but can there be much doubt that forward planning has become much more knowledgeable and perceptive of the future.

At any rate, I believe we now have the knowledge, experience, and methods of analysis to reasonably forecast the markets and demands that will be serviced from present investment. These forecasts are good enough in the aggregate to very nearly eliminate from the private sector the causes of instability inherent in the capitalistic system.

But is this increase in our knowledge of future markets and demand such as to enable one to say the business cycle is "really" dead? Unfortunately not.

A truly capitalistic economy relies on the independent decisions of consumers, investors, entrepreneurs, and savers to maintain its vigor and balance. The marvels of this equilibrating mechanism are well known to us. But it will not always work. Now and then the independent judgment of the decision makers is undermined by herd-like hysteria or pervasive apprehension or roseate expectations. The imminence of war, a booming stock market, an inflationary monetary policy are illustrative of conditions giving rise to the development of a mass psychology. Such a mass reaction may be based on a sound or unsound analysis of the situation but unless checked or offset will almost surely give rise to economic fluctuations we know as boom or recession.

In this environment and to offset the degree to which forward planning of private investment might be significantly awry we need the right kind of Government fiscal and monetary policies to insure stability. Sustained expansion in a capitalistic country rests on the creation and preservation of an environment in which saving and investment decisions are as little impeded as possible by inflation fears, political instability or lack of confidence in the wisdom of public policy. The only uncertainty the entrepreneur should be made to face is the certainty of change in the tastes of his customers and the ingenuity of his competitor.

So for the business cycle to be "really" dead we need public policies that inspire confidence by maintaining an atmosphere favorable to saving and investment. This is, I must add, much more than a negative do-nothing policy--rather, it is a posture of being prepared to use such of the economic powers of Government as are needed to achieve growth and stability in what is now known as the "Great Society."

Conclusion

The intransigent attitude of many persons toward conceding that the business cycle is dead is due to the fact that the existence of this phenomena has been for so long a convenient crutch for failure and a source of opportunity.

What political veteran or hopeful is prepared to drop this bread and butter issue from his kit of arguments? When he is an incumbent, he can alibi as a victim of the "inexorable forces" or, if fortune smiles, he can point to wise policies. And when he is "out" seeking to get "in" the economic adversity of recession is a powerful persuader.

But politics is not the only calling with a practical vested interest in keeping the business cycle alive. Think of all the economists who advise Government and business on the outlook three, six and nine months, or a year or two hence, with their predictions of turning points, future levels of GNP, the index of industrial production, etc. The elaborate paraphernalia of leading indicators, coincident indicators, laggers, and other gadgetry too extensive to refer to, for timing the path of the cycle, would all be headed for the ash can if their clients found out the business cycle was really dead.

But there is something even worse than the vested interest of professional forecasters who will eventually die off or be retreaded into more useful pursuits. Think of all the bureaus of business research at our colleges and universities and the privately endowed foundations with programs of buɯiness cycle study projected into perpetuity. How can they face their endowed objectives if the cycle is only of historical interest?

But we can get closer to home than this in illustrating the vested interests in keeping the business cycle alive--for some of you I am sure, when you return to the office, will be considering with your associates whether this is the time to sell out your cycle-sensitive stocks and buy heavily of the Treasury's latest refunding. Can you afford to admit to your clients that the business cycle is dead and that your knowledge of its intricate effect on yields and prospects is no better than dust on the shelf?

And when I return to Washington what am I going to be saying, or better yet what was I saying before I came out--I hope this speech will, at least, impress me. I have been arguing that the balance of payments has become critical and merits more positive attention than waiting for the Europeans to inflate. Why? Because we need to rid monetary policy of the constraint of fostering a level of domestic interest rates competitive with those in Europe. Until we do this we will not be prepared to use monetary action in coping with a possible recession at home.

In confessing to this stance on policy do I negate my responsibility to the affirmative position on the question before us today? I think not. I contend that the business cycle is not an inevitable characteristic of capitalism as we know it today. It is dead unless in our private actions and public policies we once again breathe life into it. This we may wrongheadedly do--but if we do plunge our economy into depression we should not blame it on the capitalistic system and an inevitable business cycle but on our own ineptitude and lack of resolution.