Henry C. Wallich
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DETERMINANTS OF THE WORLD BUSINESS CYCLE

Remarks by

Henry C. Wallich
Member, Board of Governors of the Federal Reserve System

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The world economy is recovering painfully from a severe crisis which contains both cyclical and structural elements. Among the more important structural factors are the rise in energy prices, the resulting distortion of trade flows and balances of payments, the move of LDCs into industrial exports, and, especially in the United States, the increase in the share of women and teenagers in the labor force, with their special susceptibility to unemployment.

At the same time the world has lost elements of stability to a degree that probably must be considered structural. Expectations of stability of prices and of exchange rates have been lost. So has the possibility of making reliable cost and return calculations. Prices, costs are distorted and make more difficult the creation of new jobs. Risks have increased, business fixed investment is weak. In some countries the distribution of income has shifted decisively against business.

Under these circumstances there is a temptation to try to compensate the evident weakness of the private sector by an expansion of the public sector. This, however, would tend to reduce the scope of the private sector and in that sense weaken it which in turn might lead to further expansion of the public sector. The way out of the slump would be blocked through such developments.

What is needed is a more moderate policy which allows business time for convalescence. A recession as serious as that now experienced can hardly be overcome in the course of an ordinary 2-3 year expansion. A longer time frame is needed. One cannot be absolutely sure that this recovery can reach its goals within a single business cycle, although there are no visible signals of a renewed downturn at this time.

This experience has yielded some new insights on which there seems to be increasing agreement. We have learned that inflation does not aid employment but on the contrary is destructive for employment as well as investment. We have learned that unemployment and inflation must be combatted simultaneously. We have learned further that recovery must proceed in moderation rather than precipitously. We are coming to realize increasingly that the usual methods of stimulation no longer have the effect that they perhaps had in the past. If these insights are taken to heart, we can count with a good degree of probability on a gradual return to a healthy world economy.