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NEEDED: A CYCLE POLICY

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TWO MAJOR FEARS haunt Americans, indeed, the whole world at the present moment. One is the great danger of another world war; the other is that the United States may not succeed in maintaining high levels of income and employment. Indeed, these two problems are not unrelated. The future of all of the Western democratic world depends very much upon economic conditions in the United States, and as a reflection of these conditions, the extent to which adequate aid can be given to the reconstruction of the economic systems of western Europe.

That we should be enjoying a period of postwar prosperity is not surprising to anyone. The backlogs of demand caused by the war insure high activity both in the fields of capital goods and consumers' goods; but how long it will last is the question. It could, indeed, turn out (though this is scarcely probable) that we might largely escape the immediate postwar recession — comparable to that of 1921 — by a lucky combination of circumstances. Already, something of this sort has occurred. The considerable decline in inventory accumulation in the first quarter of 1947 was, fortunately, offset by a sharp rise in the net export surplus. In 1921, on the other hand, both declined drastically, together producing a sharp depression.

But, however events may unfold with respect to the immediate postwar recession, no one, so far as I know, doubts that the backlog of demands, particularly in the fields of construction and business equipment, will in some few years come to an end. There is, moreover, widespread belief that this postwar era of prosperity is not likely to last as long as the seven good years from 1923 to 1929. There is nowhere evident currently (apart from the consideration cited below) the economic basis for so long a period of high prosperity.

To this statement one notable exception may be made, but it is not

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one that can be envisaged with equanimity. A world situation so threatening as to require very large and growing military expenditures, sufficient to offset the eventual decline in private capital outlays, might, indeed, give us an almost indefinite period of high employment. But this is a solution which would point to and probably eventuate in a world calamity. Apart from such a consideration there are few, if any, who doubt that a severe depression is, sooner or later, in store.

Nevertheless, the discussions both from the economic left and economic right have, in recent years, run in terms which, more or less, rule out the business cycle. Thus, for example, Lord Beveridge in his *Full Employment in a Free Society* comes pretty close to arguing that a long-run planned program of expansion, such as he advocates, would, of itself, eliminate the business cycle; but he does not, in fact, go that far. On the other side, more conservative writers have been disposed to talk in recent years a great deal about depressions and unemployment as though they were wholly a matter of imbalance in the *structure* of the economy. Thus it has been argued that wage-price adjustments, improved basic tax structures, labor-management relations, etc., might be so ordered that no depression is necessary.

This is a dangerous illusion. Recent discussions indicate that it is high time that we revert to a serious study of the business cycle and the factors which underlie it. It is, indeed, true that structural reforms and adaptation to changed conditions are highly important for the functioning of the economy, particularly from the standpoint of secular development and progress. But it is not true that these secular adjustments can prevent the short-run fluctuations of the business cycle. Lord Beveridge's position rests on stronger grounds, but it goes too far. It is, indeed, true that a long-run program of planned expansion will minimize the violence of cyclical fluctuations and, particularly, reduce much of the force of the cumulative process. Thus, the secondary and tertiary effects of the primary fluctuations in the rate of investment could certainly be very much minimized. But even with a planned long-run program of expansion the primary fluctuations in private investment would still remain to plague us. Bulges of investment would continue to come and go. Thus, to achieve economic stability, it is necessary not only to have a long-run program of planned expansion, but also to implement a short-run compensatory program to offset the short-run fluctuations in investment.

It may, in fact, be expected that the aftermath of the war will for some time intensify the business cycle fluctuations in investment. Serious distortions follow from the terrific "twists" which the mass conversion of the

economy to war purposes created. The accumulated shortages will intensify the replacement cycle. This will be true not only of consumers' durable goods, but also of machinery, equipment and fixed plant, and, in a still longer cycle, housing. The war has caused a violent distortion in the age distribution of automobiles, for example, and to some extent the same is true of business equipment. Thus, bulges of investment caused by the replacement cycle are likely for some time to be intensified.

In the housing field this may be very serious. After some years of feverish building the market will be largely saturated. Without a thoroughly planned urban redevelopment and housing program, violent replacement cycles will be inevitable.

But this is not all. Investment bulges spring basically from technological developments. These come typically by fits and starts and not in a smooth development of small increments of changes in technique. Often great technological innovations cause a bunching of investment. Technological developments often create vast new industries, cause relocation of population and industry, with induced effects upon investments in transportation and housing. Fundamental technological changes cause forward thrusts into new frontiers, with an attendant bunching of new investments and fixed capital. Basically, the bunching of pioneering investment is a product of intermittent surges in technology.

Thus, it is not merely the impending saturation, when the backlog of war-created demands has been satisfied, that confronts us. That, indeed, will be the basis for the first major postwar depression. The forces making for the cycle are indeed based partly on past bulges — the replacement cycle — but in a more fundamental way upon the process of technological change coming, as it does, in fits and starts.

It, accordingly, will not do to be complacent about the prospect of eliminating the cycle by making desirable corrections in the structure of our economy; and it is not true that the correction of structural imbalances will prevent the onward march of the business cycle.

The tendency to discuss the problem of mass unemployment in terms of structural imbalances is, in fact, the current counterpart of the new era talk of the 1920's. Disillusionment as a result of this point of view will follow just as surely now as then.

It is indeed true that it is not sufficient to "iron out the cycle." That might result only in stabilized stagnation and unemployment. A long-range program of expansion, structural changes in wage-profits relationship, and in the distribution of income, are necessary. What I wish to emphasize here, however, is the danger of forgetting about the business

cycle altogether. We shall quickly discover in the postwar world that our modern economy is a very fast-moving one. A depression, once it has started, can cumulate under current conditions with terrific speed. For this situation, long-run adjustment programs by themselves alone are not suitable. What is needed is a cycle policy. This means a program which can quickly be put into motion, highly flexible and subject to quick adjustment and change. It is this area that we are in danger currently of neglecting.

The President in his Economic Report transmitted to Congress on January 8, 1947, referred to the possibility of an impending recession and stated that the "government will watch this situation and be prepared for action if needed." This statement by the President is heartily to be welcomed and it is not altogether true that he was simply "whistling in the dark." We are, in fact, far better prepared to act now than we were in 1929. (This matter I have discussed at some length in my recent book *Economic Policy and Full Employment*.) Nevertheless, it is a fact that in no small measure the President *was* "whistling in the dark." We do not have a program that can quickly be put into action to stem a rapidly cumulating depression. That we will not let it run on as we did in 1929–1932, I am convinced, but we will act tardily and ineffectively because we have, in fact, nothing approaching an adequate program.

This is, indeed, a serious indictment, but all the world knows it is true; and this is the basic cause of current uneasiness with respect to the United States and its role in the world economy.

An adequate cycle program is impossible without a long-range program involving plans and preparations with respect to improvement and development projects, and public works — federal, state, and local. In one exceedingly important area a modest beginning in such a program is contained in the Taft-Wagner-Ellender Urban Redevelopment and Housing bill. But, while it once passed the Senate, there seems no prospect that it will pass the House. And it is only a beginning. Under the slum-clearance provisions of this bill, it would require fifty years to purchase and redevelop the slum and blighted areas and to provide reasonably satisfactory houses for the mass of the population. That a country with the prodigious productive capacity demonstrated in the war can seriously consider taking half a century to improve basically its great urban communities, remove the slum and blight, and modernize urban transportation is a striking proof of the lag of social adjustment to technological change.

There has been a disposition of late to minimize the anticyclical possibilities in a public investment program. There are, indeed, great difficul-

ties which have often been slurred over. But the pendulum has gone too far. We need to re-examine the possibilities of flexible adjustment inherent in a large and varied long-range public construction, improvement, and development program. Unless this is done, we shall, in fact, engage in wasteful expenditures, once a serious depression is upon us, for we shall discover that it is not possible to meet the onrush of depression without a large expansion of public outlays. Such outlays can be wisely implemented, not merely in public works, improvements, and development projects, but also in low-cost housing and, indeed, in other kinds of durable consumers' goods. The last item in particular has been explored at some length in the postwar programs in western European democracies, notably, the British Empire countries and the Scandinavian countries.

Urgently necessary, if we are going to implement a really effective anti-cyclical program, is a flexible tax system. Nothing is more immediately important than public education on this important issue. With a vast federal budget somewhere in the neighborhood of 35 billion dollars, the anticyclical possibilities inherent in a flexible tax system are enormous. It is not possible to run the modern fast-moving economy, with its tendency toward violent fluctuations, on the basis of an immovable tax structure fixed for two or more years.

Recently the whole country debated the question of the new tax bill. It is extremely interesting to note that it was debated in terms of depression and inflation. These are short-run business cycle matters, and if the rates are to be countercyclically effective, they must be timed. But timing is obviously impossible under the system now in vogue. While the discussion was going on in Congress, the country was under strong inflationary pressures. This indicated the maintenance, if, indeed, not the increase in tax rates. On the other hand, there was looming the danger of impending depression. This situation would indicate a sharp reduction in tax rates. But no one could pretend to say with any accuracy when inflationary forces would subside and deflationary forces take hold.

Thus, while the debate shows that the country is quite aware that taxes are important for the control of both inflation and deflation, it is apparent that the instrument is not now at hand to effect appropriate timing in an anticyclical program. Since this is true, it is apparent that we have not yet reached a stage of sufficient economic and political maturity to manage the tax program in a manner required to insure a well-functioning and balanced economy.

Just as Congress has, within limits established by law, empowered the executive to make adjustments in tariff rates, and just as Congress in the

Federal Reserve Act has allocated to the monetary authority, within limits established by legislation, the power to raise and lower reserve ratios, so also it now becomes highly important and, indeed, essential to permit executive adjustment of the basic income-tax rate within limits imposed by Congress. Only in this manner is it possible to get quick timing and an adequate flexibility in our tax structure. The President should periodically report to the Congress, annually in his Economic Report, and probably quarterly, on action which he may or may not have taken, together with reasons for his action. In the final analysis, the power would always reside in Congress not only to lay down the basic pattern within which the executive operates, but also to intervene if it so chooses. Thus, Congress would in no sense abdicate its power but would only make possible an implementation of the tax system as an effective anticyclical device.

There is general agreement that we stand in danger, sooner or later, of serious depression and mass unemployment, and that this is a definite menace to the very existence of democratic government, to the system of free enterprise, and to the market economy operating mainly under the price system and private enterprise with the state playing an important regulatory (and in some areas a state-enterprise) role — in short, the so-called mixed system which characterizes all Western democratic countries, even the United States. But despite the general agreement about the danger of depression and mass unemployment, it is a tragic fact that there is little agreement about how to meet the danger. There is a disposition to take a chance, to hope for the best, to let well enough alone.

The fact is that we have not been able to resolve the basic problem of the role of government in our modern world. Particularly, we have not learned how to make government an effective, flexible, and responsive instrument in a varied and highly complex society. This society embraces activities and institutions that are voluntary and noncoercive — a society functioning mainly through private enterprise, co-operative action, and numerous private institutional arrangements, yet a society in which the state functions not only as a balance wheel offsetting fluctuations in the private sector, but also as a provider for evergrowing community services and for basic development projects which underlie and support private industry.