Volume Title: Conference on Business Cycles

Volume Author/Editor: Universities-National Bureau Committee for

Economic Research

Volume Publisher: NBER

Volume ISBN: 0-87014-193-7

Volume URL: http://www.nber.org/books/univ51-1

Publication Date: 1951

Chapter Title: Business Cycles in a Planned Economy

Chapter Author: Gottfried Haberler

Chapter URL: http://www.nber.org/chapters/c4768

Chapter pages in book: (p. 375 - 404)

BUSINESS CYCLES IN A PLANNED ECONOMY

GOTTFRIED HABERLER, *Harvard University*

I

One of the main advantages claimed for comprehensive economic planning is that it would do away with the business cycle. In a planned economy, its advocates say, the waste of recurrent, cyclical depressions would be eliminated and, needless to add, there would be no room for chronic unemployment and secular stagnation. There may not be literally full employment all the time, but general cyclical unemployment and, of course, general long-run unemployment from which unplanned 'mature' economies are supposed to suffer are effectively barred from planned economies.

But is this claim really justified? Is a planned economy really immune to cyclical fluctuations? Or are there fluctuations of a different nature and different time shape? If there are really none at all, what is the price, in terms of regimentation, long-run efficiency, and progress, which the economy has to pay for that immunity?[1]

Nobody will deny that these are important questions. But they are not easy to answer. They are really unanswerable if we want to live up to the austere and exacting principles of scientific procedure and proof that govern the work of the National Bureau of Economic Research. I am afraid we shall have to lower our standards of scientific rigor quite a bit and indulge in a considerable amount of theorizing, speculation, and guessing in order to be able to say anything at all!

We shall have, first, to clarify what exactly we mean, by 'business cycle'. Later it will be necessary also to get some idea about the nature of the causal mechanism that is responsible for the cycle. Without any idea about the forces that produce cyclical fluctuations in economic activity, it is impossible to decide whether there will be such fluctuations in a planned economy. Only if we had a large amount of empirical material concerning planned economies, that is to say, if we could observe whether planned economies have in fact been subject to cyclical fluctuations, could we

[1] The informed reader will recognize that the views expressed in this paper are similar to those of David McCord Wright. See his article How Much Can Planning Do, *Journal of Political Economy,* August 1948, and his *The Economics of Disturbance* (Macmillan, 1947). See also Wilhelm Roepke, Socialism, Planning and the Business Cycle, *Journal of Political Economy,* June 1936.

hazard a generalization without first forming an idea about the causes of cyclical fluctuations, then investigating whether these causes are likely to be operative in a planned system. It will hardly be disputed that the factual material available is insufficient for such a purely empirical approach.[2]

Secondly, we must decide what we mean by a 'planned economy'. The concept 'planned economy' is much too vague to be of any use without further clarification and distinction of different types. What holds for an economy of a certain degree and type of planning need not hold for another.

II

Let us start with the definition of business cycles given by Wesley C. Mitchell and Arthur F. Burns (*Measuring Business Cycles,* p. 3):

> Business cycles are a type of fluctuation found in the aggregate economic activity of nations that organize their work mainly in business enterprises: a cycle consists of expansions occurring at about the same time in many economic activities, followed by similarly general recessions, contractions, and revivals which merge into the expansion phase of the next cycle; this sequence of changes is recurrent but not periodic; in duration business cycles vary from more than one year to ten or twelve years; they are not divisible into shorter cycles of similar character with amplitudes approximating their own.

We may make this definition a little more definite by substituting for "fluctuations in aggregate economic activity" "fluctuations in real output (physical volume of productivity, real national income), employment (measured by the number of labor hours) and unemployment".[3]

[2] There are a few interesting cases. The planned economy of Nazi Germany did not show any trace of the short but sharp depression of 1938 that visited the United States and a large part of the world. The 1949 depression or recession in the United States did not spread to Great Britain.

Nobody would want to generalize from so few instances. But even a few cases may have great scientific value if they are used for the purpose of verifying or rejecting a general theory which is derived independently.

[3] I know the masters of the National Bureau do not like to pin themselves down by singling out any one magnitude as the precise measure or criterion of the cycle. There is much to be said for that attitude. Especially at the beginning of an investigation it is probably wise not to restrict oneself too much by adopting a precise definition. My point is, however, that general research on the cycle and that of the National Bureau in particular has gone far enough to permit us to be a little more specific than to speak vaguely of economic activity, although it must be conceded that absolute precision is hardly attainable in such matters. Let me refer to the interesting remarks made by an eminent philosopher and mathematician. Herman Weyl has this to say on the role of "ordering and classification" as a preliminary stage to "causal analysis proper". In a new appendix to the English edition of his celebrated *Philosophy of Mathematics and Natural Science* he writes (p. 286): "We saw how causal analysis proper is preceded by ordering and classification. Perhaps more stress should have been laid [in the first edition of his book] on this prelimi-

It is hardly necessary at this point to enter into a lengthy discussion about the logical relationship of these various magnitudes, the precise definition of unemployment, the possibility of a divergence of these criteria, the elimination of trend in output and employment, etc. But it is important for our purposes to point out that the above definition is obviously still too broad inasmuch as it includes what we might call technologically determined fluctuations in output and employment.[4]

By this I mean the following: Output may conceivably fluctuate because of physical mishaps in the productive process such as earthquakes, floods, wars, crop failures, strikes. Changes in output, employment, and unemployment due to these causes do not constitute business cycles and must be excluded. This, however, does not exclude the possibility that such occurrences do affect, one way or another, the business cycle proper. (That they may, according to circumstances, influence it in the upward or downward direction, that, for example, an earthquake or a crop failure may be an expansionary just as well as a depressive factor, shows clearly that we have two entirely different phenomena.)

Similarly, unemployment may be created by a physical disturbance: for example, an accident in production, a breakdown of transportation, or an interruption of imports of fuel or raw materials may cause the shutdown of processing and manufacturing industries and unemployment. By business cycles we mean fluctuations in aggregate output and employment that are not directly due to such purely 'physical causes'; or expressed positively, that are *proximately* due to fluctuations in aggregate expenditure (often called 'effective demand') in relation to the price level. Practically speaking, all major fluctuations in output and employment without exception seem to have been associated with fluctuations in the flow of expenditures: money and real income fluctuate together although, of course, not necessarily with the same amplitude and not around the same trend. But fluctuations in aggregate output and employment are conceivable, even with a *constant flow of money expenditure* (effective demand, money

---

nary stage, that still plays a major role in biology while it has become of subordinate importance in physics." Can anybody doubt that economics is, as far as its degree of development is concerned, closer to biology than to physics? A little farther down on the same page Weyl continues: "The remarkable fact that the diverse species, notwithstanding their range of variation, mostly exhibit clearly recognizable typical differences, has facilitated the task [of classification]." In that respect the situation is less favorable in economics than in biology, especially when we are dealing with such all-embracing complexes as the business cycle. But consider the following, comforting remark: "The typical may be elusive in terms of well-defined concepts, and yet we handle it with instinctive certitude, e.g., in recognizing persons." Let us hope the same is true of business cycles!

[4] Not identical with 'technological unemployment' in the usual sense.

national income): fluctuations in the price level (or cost level, for example wage level) may bring about fluctuations in total real output. But in that case an uptrend in prices would be associated with a downtrend in output and *vice versa,* rather than the other way round. To cover those cases I said "fluctuations in effective demand *in relation to the price level*". If we exclude these cases as practically unimportant the italicized qualification would be unnecessary. In actual fact, however, prices and production (output as a whole) are almost always positively correlated. (Minor exceptions occur at the lower turning point at which it sometimes seems to happen that prices continue to fall after output has turned the corner.)

The deeper reasons for these cyclical fluctuations, the inner structure of the cyclical mechanism, raises all the intricate questions of business cycle theory. It is obviously impossible to attempt at this point the construction of a complete business cycle theory. But there can be hardly a doubt that fluctuations in investment, inventory investment as well as investment in fixed capital, building, and consumer durable goods, are the main villains of the piece.

The determining factors behind investment cycles, the building blocks out of which any theory will have to be constructed, are, roughly speaking, these:

1) Exogenous factors: inventions and innovations. (That we call them exogenous does not exclude the possibility of explaining them, or some of them, within the framework of a partly sociological theory of the cycle. See, for example, Schumpeter's theory.)

2) Wars which create large backlogs and give rise to a bunching of investment which will tend to recur in damped waves through the well known mechanism of the replacement cycle.

3) Technological facts: the durability of instruments, high capital-output ratio (acceleration principle in some form).

4) The expectational behavior of entrepreneurs, Pigou's waves of optimism and pessimism.

5) Credit mechanism and banking policy.

6) Propensity to consume and its fluctuations.

I personally have become more and more impressed with the importance of the psychological factor. One reason is the fact, confirmed and underlined by recent experiences, that economists themselves are strongly under the influence of the prevailing cyclical phase. During the 'great depression' of the 1930's economics became depression economics. Theoretically the Keynesian system is, of course, not pure depression economics. But what is relevant in this connection is that the majority of Keynesians projected the depression phase deep into the war and postwar inflation. When they took cognizance of postwar inflation, the inflation phase was almost over.

Many economists missed the boat again and recommended anti-inflation policies many months after the first postwar depression had begun. So it happened that the Council of Economic Advisers in their Report of January 1949 expressed the opinion that "stabilization policy for the immediate future is still concerned mainly with restraining inflationary forces" (p. 74), four or five months after price inflation had reached its peak and the depression or recession was well under way. If economists themselves, who as detached scientists should be watching the cyclical gyrations of the economy with cool and objective minds, are carried away by events and are induced to extrapolate — with a lag — the current phase of the cycle into the future, is it not plausible that the real actors on the economic scene, the business men, should be subject to the same optimistic and pessimistic exaggerations?

To repeat, we are not yet in possession of a comprehensive theory of the business cycle. But I think we can sketch what we may be pretty sure will be the elements of such a theory.

Let us start with a peacetime upswing. This may follow after a depression or after a war boom with only a rudimentary depression intervening.[5]

In either case there is a backlog of investment; a larger one, of course, in the case of a postwar boom. This backlog will carry along the upswing for some time. Practically every theory of the cycle describes the cumulation process of expansion as a mutual stimulation for investment and consumption; in modern terminology we speak of an interaction of multiplier and acceleration principle, but the essence of the matter is contained in pre-Keynesian theory, e. g., in the 'Wicksellian process'.

The monetary ingredients and presuppositions of the upswing have been analyzed by scores of writers: During the preceding depression or war the economy has been saturated with liquid funds and the banking system has been put in shape to finance the upswing. There are usually intensifying factors: the upswing creates an atmosphere of optimism which affords a favorable climate for new ventures and innovations necessitating further long-range investments. Moreover, price rises lead to price speculation and speculative inventory and other investments. This is a type of investment that obviously carries the seeds of its own destruction.

But even apart from price speculation booms do not last forever. More than that, they never issue in a long-lasting plateau of full employment. They are like a cyclist, they keep going or they collapse and are followed by a depression.

[5] After World Wars I and II the postwar boom was separated from the war boom by only a very mild depression, if we call it one. Using the National Bureau's dates I am referring to the depression from August 1918 to April 1919, not to the depression from January 1920 to July 1921.

The change from prosperity to depression, from upswing to downswing, is the most crucial problem of the cycle. I still believe that we need a special theory, or rather alternative explanations, of the turning points. The cumulative process is always essentially the same, but we cannot be sure that the turning point is always brought about by the same factors (even apart from possible disturbances from outside the economic system) or that the same system of difference equations will satisfactorily describe the upswing as well as the upper turning point.

Mathematical and econometric cycle theorists do not like that idea.[6] They want the whole cycle theory made of one cloth — *aus einem Guss* — and frown upon any theory that does not deliver such a system as eclectic and inelegant. But who tells us that reality itself is not eclectic? And as to elegance we may say with Boltzmann that questions of elegance should concern tailors and shoemakers rather than scientists. Moreover, if econometricians try hard enough they will be able to cast eclectic theories in difference equations! Hicks' extremely suggestive article in *Economica* shows that mathematical theory is beginning to catch up with literary analysis.[7]

The most likely factors bringing about the end of a cyclical upswing (apart from purely extraneous disturbances) seem to be these:

1) The boom may simply peter out, i.e., investment opportunities may *temporarily* be exhausted and it may take time before new ones are developed. This is obviously akin to Schumpeter's theory, although he gives it a slightly different twist.

2) The factor that produces the downturn in Metzler's inventory cycles (and in scores of similar models) is also a drop in investment, namely, investment in inventories. But it is a different case than the one mentioned under (1), because it is a fall of *induced* investment which could be easily forestalled or corrected by a rise in consumption expenditure.

3) The boom may hit the ceiling of full employment. It is easy to show why the system will be thrown into a depression instead of staying for a long time at the full employment level. It is also easy to substitute for a rigid ceiling "a zone of increasing resistance" (Hicks), bottlenecks, and the like.

[6] See, e.g., Metzler's contribution to *The New Economics* (Seymour E. Harris, ed., Knopf, 1947) where he claims for what he calls the "modern view" in cycle theory that it dispenses with the necessity of introducing bottlenecks and other limiting factors for the explanation of the upper turning points. But what he calls the modern view is a simple theory of the interaction of multiplier and acceleration which is really too simple to be taken as a satisfactory explanation of reality.

[7] May 1949, Mr. Harrod's Dynamic Theory. See also his little book, *A Contribution to the Theory of the Trade Cycle* (Oxford University Press, 1950) — a real gem in the theoretical literature.

4) Under the gold standard in olden times the ceiling might be purely monetary.

5) Another possibility of special importance today in the era of aggressive trade unions and easy money policy is that price inflation will develop long before full employment is reached. If inflation is then stopped by credit restriction and fiscal policy, a depression is the immediate and natural consequence.

The downswing, the cumulative process of contraction, is of very much the same nature as the upswing with signs reversed, and the lower turning point (revival) presents problems similar to the upper turning point and is likewise subject to alternative explanations.

The essential elements in the whole cyclical process — apart from the unavoidable technological facts that production takes time and larger and larger amounts of fixed capital are necessary per unit of output — seem to be these:

Investment is at least partly geared to the movement of the system (acceleration principle in the broad sense).

Investment is governed by the profit motive and expectations. If investment were carried on according to long-run objectives, irrespective of short-term fluctuations in output, the situation would be entirely different.

Especially inventory investment is very volatile. Abramovitz' fundamental researches have confirmed Hansen's conclusion that inventory investment accounts for a very substantial part of the fluctuations in total output and can, by itself, explain what Schumpeter calls the Kitchin cycle and Hansen the minor cycle.

Expansible money and credit supply is undoubtedly an indispensable condition for the business cycle. But very few writers would be ready today to attempt a complete explanation of the cycle in terms of monetary and banking arrangements and policies.

III

We have now to apply the analysis of the forces that make for cyclical fluctuations in the free enterprise economy to planned systems. But what do we mean, precisely, by a planned economy? What kind of planning do we envisage?

'Planning' has come to mean many things to many men. On the one extreme we have the thoroughly and centrally planned economy of the Russian type — or rather as the Russian economy is commonly supposed to be organized and managed. (Competent observers claim that real central planning is an impossibility and that it is a myth that the Russian economy is centrally planned; see, e.g., Michael Polanyi, *Full Employment and Free Trade* (Cambridge University Press, 1945).

On the other extreme there is the case of the free enterprise economy with a strong counter-cyclical monetary, credit, and fiscal policy. The present American system belongs in that category. Some economists call that sort of policy 'planning' (e.g., S. E. Harris in his recent book on planning). Others would object. Whatever one chooses to call it, I shall not consider this case here; nor shall I be much concerned with the other extreme, the fully and centrally planned economy of the Russian type. I shall deal with intermediate types, with economies 'controlled' or 'planned' on the pattern of the German economy under the Nazi regime or of present day Britain:[8] heavy industries, transportation, public utilities, international trade are partly nationalized, partly under strict control; there is stringent credit control, direct investment control, allocation of economically strategic raw materials and equipment; there is, furthermore, price and wage control and possibly some consumer rationing.

Could there be a business cycle in an economy organized along those lines? Would those forces and factors that produce a cycle in the free enterprise economy operate in such a planned economy, and, if so, what would be the consequences?

In planned economies, undoubtedly, situations must occasionally arise that in a free capitalistic economy would lead to a more or less prolonged general depression. Take, for example, a typical postwar situation. The

[8] There is surprisingly little difference between the methods of economic control in Nazi Germany and Labour Britain. In fact Schacht himself seems to have been much less of a convinced Schachtian than his British imitators and admirers. But given (a) the full employment postulate, (b) the insatiable government and Party demands and the consequent inflationary pressures, (c) an overvalued currency, (d) the postulate that the price level must be held constant, there was little room for Schacht to do anything except what he actually did.

On the whole, in peacetime the Nazi economic system seems to have worked better than the present British system. The reason seems to me not that Britain is a democracy while Schacht could use the police power of a ruthless dictatorship. Democracy in Britain is certainly of inestimable value especially because it holds out the hope for a peaceful change in policy. But it has not yet hampered the Labour government in its policy of economic regimentation. The real reasons for the comparative success of the Nazi economic system seem to be these: (a) Hitler was presented by his predecessors with the invaluable asset of many millions of unemployed which enabled him to supply the German people for a long period with guns and butter at the same time, while the Labour government was saddled with war dislocations; although it must not be forgotten that it, too, received a handsome dowry, consisting of a smoothly working system of controls inherited from the war and of the possibility of utilizing a couple of millions of demobilized service men, which could be directed into appropriate channels. (b) The Nazi system was not hampered by the constricting and retarding practices of powerful labor unions. It was in a better position to resist demands for higher wages and lower hours. It was not harassed by strikes and managed to maintain efficiency on a high level.

war has created a great backlog of demand for investment in inventories, houses, industrial plant and equipment, etc. The ensuing postwar boom is likely to induce price inflation of some severity, how severe depending upon the methods of financing the war and the energy with which inflation is restrained by monetary and fiscal measures. It can be argued that the severity of the depressive reaction following the boom will depend at least to some extent upon the degree of the concomitant inflation: the more the inflation is restrained, the longer the period over which the restocking of the economy with capital is spread and the milder the following reaction.[9]

But an inflation under such circumstances is almost unavoidable, and even if, by heroic measures, it were entirely prevented there would still be no assurance that when the replacement demand for capital[10] is satisfied there will be a smooth transition to some other kind of investment.

A similar situation can easily arise in connection with a Schumpeterian peacetime boom propelled by some new type of investment. Or postwar replacement demand may easily be combined with some capital intensive innovation boom. A good example is the Juglar boom of the 1920's which was fed by a combination of war-deferred investment and investments entailed by the rapid motorization of the country. In all these cases investments are bunched and a consequence is a *temporary* lack of investment opportunities which is likely to spell a more or less prolonged depression.

How would a planned economy cope with such a situation? Or is there a reason why such contingencies should not arise there?

It would be entirely gratuitous and even question begging to say that in a planned economy such situations could not arise because the supreme economic council (or whatever the planning authority is called) would survey the whole field and would therefore not make the mistake of general or partial overinvestment. This is not true of a centrally planned economy, still less of the intermediate type with which we are concerned. In the first place there need not be any overinvestments in the sense that oversanguine expectations of future demand for some particular product has led to excessive investment and overcapacity in some branches of industry. For example, the quick replacement of capital used up and destroyed in war need not be irrational or faulty in that sense and may still leave a temporarily insufficient investment demand once it is finished. But second, there is no assurance that public bodies are immune to genuine overinvestment. There is no evidence that they have a superior power of foreseeing future demand

[9] The outcome depends, however, not solely upon the degree of the price rise but also upon the relative movement of wages and profits. But we need not go into those relationships for our purposes.

[10] 'Replacement' in the historical sense, compared with the prewar situation, which really is demand for new capital in the current sense.

as compared with private entrepreneurs. On the contrary, evidence is beginning to accumulate that they are prone to make the same mistakes of overestimating existing deficiencies and future demand that are occasionally made by private producers and are often attributed to the 'competitive illusion' or similar factors. Witness the controversy between public officials and private producers concerning the steel capacity in the United States that has been going on during the last few years. It seems to be pretty clear by now that if the steel industry had followed the advice of public planners it would have aggravated the scarcity of steel during the boom years and created excess capacity later on. In other words, the cyclical fluctuations would have been accentuated.[11] British and French experiences point in the same direction. The cyclical reactions of the directors of nationalized industries and of governmental planners seem to be subject to even worse optimistic exaggerations than those of private producers. Temporary scarcities after the war have led to excessive estimates of required larger capacity. That on an international scale national 'planning' has produced in recent years tremendous duplications implying huge malinvestments in many branches of industry all over Europe is notorious. True, it should be possible to avoid the worst mistakes by international planning or international coordination of national plans. This paper is not the place for a discussion as to whether international planning is at all feasible from a political point of view. But surely the record shows what was really to be expected — that planners are not only fallible but are probably possessed of less foresight than private investors.

Let us take it for granted, then, that situations such as those indicated above, which under a private enterprise economy would spell depression, would also arise in planned economies. Would the consequences be different?

However serious the maladjustments developed during a boom, or however large the immediate lack of promising investment opportunities, it is hardly thinkable that in a planned economy a cumulative process of contraction would be allowed to go very far. Even if the private sector of the economy reacts very unfavorably, the chances are that in a planned economy antidepression policy will, if anything, be pursued too vigorously rather than too timidly, in the sense (a) that it will not only cut out the wholly undesirable 'secondary deflation' but also prevent or unduly postpone the necessary and desirable corrections of the maladjustments (malinvestments) that gave rise to the contraction; or (b) if there were no outright maladjustments but simply a temporary petering out of invest-

[11] This seems to be true even if an unnecessary depression is avoided. On the other hand, the planning officials may still be right in the long run, if war contingencies are taken into consideration.

ment opportunities, that investment in unpromising lines will be continued and the search for new outlets unduly delayed.

Let me repeat and amplify. My contention is a double one. (1) In a planned economy the cumulative process of contraction will not be allowed to develop or will be speedily arrested. The reason is partly that the public sectors of the economy are likely to react differently and partly that vigorous antidepression policies will be adopted. In the nationalized sectors it is not likely that investment will be quickly curtailed when prospects look a little less favorable. Inventory liquidation is not likely to be pushed vigorously. On the other hand, if a contraction develops in the private sector the planned or controlled economy is in a better position than the free enterprise economy to institute antidepression measures promptly. The greater the public sector of the economy and the stricter the control over the rest, the easier it is to act promptly in such a way as to offset any decrease in aggregate expenditure ('effective demand') in some part of the system. (2) The other side of the medal is that necessary and desirable readjustments and relocations of productive resources will be delayed or perhaps indefinitely postponed.

IV

I am aware that I am treading on thin ice. The underlying theory of cyclical depressions or of the cycle as a whole requires more proof and more elaborate defense against possible objections than can be provided within the frame of this paper. Moreover, the entire issue of the advantages and disadvantages of comprehensive economic planning is highly charged with emotion. This paper is surely not the place for a thorough discussion of these issues. Our subject is a much narrower and technical one. But certain implications for the broader issues are obvious and unavoidable.

Let me therefore try to summarize as clearly and succinctly as I can what I have been attempting to say.

The underlying theory or philosophy of the business cycle may be conveyed by concentrating on its depression phase. I conceive a cyclical depression as having two aspects as it were. It is on the one hand — and this is, at least in severe depressions, the more important aspect — a general deflation. But it is rarely a deflation *pure et simple*. This is to say, the deflation has been started, in most cases, by a real maladjustment, a disequilibrium in the structure of production, i.e., an overexpansion of some and underdevelopment of other branches of industry. This is a condition that requires for its correction some reshuffling of productive resources, a transfer of labor and capital from some branches of the economy to others. This transfer is accompanied by a general deflation. The two processes, the deflation and the correction of the structural disequilibrium, are interrelated and concomitant.

In the literature we can distinguish three schools of thought about these problems. There are, first, those who stress the real disequilibrium to the exclusion of the general deflation; they ignore the latter or regard it as an unimportant and, at any rate, unavoidable concomitant of the real trouble of the disequilibrium in the structure of production.

There are, secondly, those who see the essence of the depression in the general deflation and believe that any real disequilibrium, if it exists, will easily take care of itself if effective demand is maintained, if the general deflation is not allowed to develop.

There are, thirdly, those who emphasize both aspects and believe that neither can be neglected. This is the position taken here.

The first view either ignores the deflation or thinks that nothing can be done about it without perpetuating, recreating, or even accentuating the basic real disequilibrium.

The second view regards the deflation as wholly unnecessary and pathological.

The third group thinks that the deflation goes usually much further than can be justified on the ground that it helps to correct a basic disequilibrium. Suppose that there is such a disequilibrium. Industry A is over-expanded compared with industry B. This condition requires a transfer of productive resources from A to B. One would expect the correction to take the form of losses, unemployment, deficiencies of demand, and falling prices in A, and of brisk demand, high profits, rising prices, and prosperity in B. But what we see in every cyclical depression is *general* unemployment and falling prices everywhere.[12]

It is hard to see how a general deflation should facilitate the transfer of resources. On the contrary, it obviously impedes it. If industry B as well as A is depressed, B will not attract resources from A. The only real function of a general deflation and of the general unemployment the deflation engenders is this: Unemployment may be necessary (a) to keep in check inflation resulting from continuing pressure by trade unions for a rise in wages exceeding the increase in efficiency and (b) to maintain efficiency which is also threatened under a regime of full or overfull employment.[13]

Apart from these two conditions, which ought to be corrected at the source, a general deflation cannot be regarded as having any useful function.[14] The contention of this paper is that there is not only no assurance,

[12] Of the economists who belong to the first group it is Professor Hayek who has seen this dilemma most clearly. He has tried to dissolve it, but without success in my opinion.

[13] (b) is included by (a) if by 'wages' we mean 'efficiency wages' for efficiency wages rise when efficiency falls.

[14] Something is to be said, however, for a fall in prices during the depression phase

but not even any likelihood that a planned economy would avoid such maladjustments and such miscalculations and misdirections of productive resources as in a capitalist economy produce depressions. It would probably create its own disequilibria and would be inefficient and slow in correcting them.

On the other hand, a planned economy would not allow general depressions to develop, and if such a depression threatened to develop in the private sector, the planned economy would be in a good position and would surely not hesitate to counteract vigorously. The upshot is that there would be no business cycle as we know it or that it would be stopped in its tracks.

It would be most interesting to investigate the implications of what has been said for the broader issues about the alleged superiority of a planned economy. The outcome will largely depend on the answer to the following two questions: First, to what extent is it possible in an unplanned free enterprise and price economy to mitigate the wastes of cyclical depression by means of monetary and fiscal policy? Personally I would say that this can be done to a very large extent: that what we have called the 'secondary deflation' can be reduced to minor proportions by monetary and fiscal policy.[15] The second question is how planning affects long-run progress and efficiency. But this is a problem clearly outside the scope of this paper and of our Conference.

COMMENT

ABRAM BERGSON, *Columbia University*

1) Let me say at once that in all essentials Professor Haberler's argument seems entirely reasonable to me. He places much emphasis on the role of structural maladjustments in capitalist business cycles. I must confess that I have no very firm convictions on this matter one way or another. But certainly under socialism mistakes will be made, and no doubt, as Pro-

---

of the cycle as an offset to the rise in the price level during the boom. If prices are allowed to rise during the upswing of the cycle but are not permitted to fall sufficiently in depressions, the price trend will be in the upward direction, which must have very serious consequences in the long run, especially from a social point of view.

[15] Except that it may be necessary to have a certain volume of unemployment in order to maintain efficiency and to prevent inflation from being created by continuous wage rises.

fessor Haberler implies, more than minor ones. At the same time, it seems hardly likely that there will be business cycles as we know them. At least, given a reasonable degree of control over the economy generally, and over investment policy in particular, the planners should be able to dampen appreciably the cumulative swings. This, as I understand it, is Professor Haberler's main conclusion, and I see no reason to question it.

2) Professor Haberler does not comment explicitly in his paper on the case considered by Professor Wright, where maladjustments arise because of a possible tendency to overbuild the durable goods industries. The capacity required to build up stocks of durable goods might exceed that required to maintain these stocks after they had been built up. Obviously this situation might be an important source of mistakes under planning. It seems to me Wright has performed a useful service in emphasizing this aspect. It should be observed, however, that unless there *is* a mistake, the indicated excess capacity is not to be compared at all with the overinvestment that occurs under capitalism. Very possibly, on various counts, the planners might decide in advance that the durable goods capacity should temporarily be expanded beyond the normal replacement rate. In this case, proper accounting procedures presumably would call for the writing off of the value of the durable goods capacity in the course of its service life; accordingly there never would be any excess capacity in an economic sense, any economic waste. In commenting recently on this aspect I assumed that Wright was under a misapprehension;[1] on the basis of correspondence we have had since, I am glad to record here that we are in essential agreement.

3) In his paper Professor Haberler focuses primarily on planned economies of a mixed sort, where private enterprise is still predominant. Perhaps it is in order to refer here to the case where public ownership is predominant, and particularly to the outstanding example, the USSR. In view of the limitations of time, I fear I can do little more than state rather dogmatically my main conclusions, but perhaps the comments will be of interest nevertheless, at least as a stimulus to further thinking. Briefly there are two points to note, though each is subject to a qualification to be mentioned:

a) In view of the general nature of the Soviet economy, particularly the extensive controls exercised by the planners, it would seem that Professor Haberler's reasoning must apply here and, if anything, with greater force. One is inclined, thus, on purely *a priori* grounds to rule out anything like the capitalist business cycle.

b) Reference to empirical data on Soviet economic development would seem to lead to the same conclusion. At least for the period of the five year

[1] Abram Bergson, Socialist Economics, *A Survey of Contemporary Economics*, Howard Ellis, ed. (Blakiston, 1948), pp. 438-9.

plans, the main contours of Soviet economic development are largely explicable without reference to anything like the cumulative swings of capitalism and simply in terms of: (i) a scale of broad priorities imposed by the top planners, involving a more or less high preference for heavy industry over other sectors, and within the heavy industry sector, depending on the circumstances, shifting relative values for basic industrial and munitions production; and (ii) changes in what, subject to obvious reservations, may be considered underlying data for economic planning, e.g., the fantastic losses of livestock under collectivization; the purges, with the resultant impairment of managerial capacity, etc.

The qualification is intended to take account of the following aspects:

a) Inevitably there is some decentralization of decision making in the USSR, and probably more than is commonly supposed. Even the operating units at the bottom of the hierarchy seem to exercise important functions not only within the framework of the plan but in the formulation of the plan itself.

b) The limitations in empirical data, at this stage at least, rule out anything like a detailed assessment of Soviet economic development.

Under the circumstances, the possibility seems open that to a significant extent the Soviet economy leads a life of its own, quite apart from the will of the planners. In other words, while the business cycle is ruled out, there may be important forces at work in the USSR more or less comparable with the 'endogenous' forces of capitalism.[2]

4) In referring to Soviet economic development above, I had in mind primarily the physical aspects. On the financial side the outstanding feature is a more or less chronic wage and price inflation, and perhaps a few observations are called for here on this aspect. First, the inflation, in so far as it was more or less characteristic of the entire period, hardly fits into the pattern of capitalist business cycles. Second, perhaps, as has sometimes been suggested, it was to some extent uncontrolled, and hence reflected 'endogenous' forces. But, third, very likely there was an important policy element, perhaps based in the last analysis on such aspects as monetary fetishism on the part of the workers; the need to alter the wage structure greatly in favor of heavy industry and the possible advantages, in view of the monetary fetishism, of raising some rather than lowering other wages; and

[2] This analogy seems weakened, however, if account is taken of one other aspect: within the framework of the broad priorities of the top planners there apparently is an appreciable degree of indeterminacy in controls over decision making at all levels. While this means that the decentralization is more important than it might otherwise be, it also means that there must be a good deal of arbitrariness in decision making. Discussions of the 'endogenous' forces of capitalism usually presuppose a more or less determinate type of economic behavior.

administrative factors favoring indirect rather than direct taxes as a means of absorbing excess purchasing power.

Finally, even though controlled, the inflation might possibly indicate indirectly the importance of 'endogenous' forces in the physical sphere. As a matter of policy, inflation might be used as an instrument supplementary to planning to direct economic activity. In other words, there might be a case here of the sort recently discussed in other contexts where, because of the limitations of planning, inflation is needed to assure continued high level activity. Reasons to discount this aspect in Soviet conditions, however, are the following: (a) to a great extent the inflation was apparently overt rather than suppressed, and hence would be mainly significant as a factor buoying up profits; (b) the resulting extra profits, however, were largely taken into the budget in the form of a turnover tax, and accordingly did not accrue to the accounts of the operating units; and (c) in the current expansive phase of Soviet development achievements in production are probably a more important factor in managerial success than a good profit record.

5) A word finally on the matter of unemployment. There is hardly any reason to question the Russian claims that mass unemployment has been liquidated under their five-year plans, and certainly they are entitled to point with pride to their achievements in this regard. But in attempting an independent appraisal account should be given two aspects, which they pass by. First the possibility, suggested by an inspection of available data, that the period studied witnessed a deterioration of urban in relation to rural real incomes. If this deterioration occurred, presumably it would have retarded rural-urban migration; the final result may have been in part the replacing of visible unemployment in the cities by disguised unemployment on the farms. Second, the notably high tempo of development, which means that mistakes in particular industries can readily be dealt with by relative retardation and need not lead to any absolute contraction and release of labor.

ADOLPH LOWE, *New School for Social Research*

Like Professor Bergson I find myself in agreement with many essential propositions expressed in Professor Haberler's paper. I shall confine my comment to three issues regarding which further clarification seems to me possible and desirable: Professor Haberler's formulation of the problem; his analysis of the cyclical process in a planned economy; and finally, some sociological implications of his paper that should be made explicit.

1 FORMULATION OF THE PROBLEM

What is the precise nature of the two systems Professor Haberler compares? His paper is quite explicit as to what he means by planning. He has confined his analysis to an intermediate type of economic organization somewhere in the middle between *laissez faire* and full collectivism. His prototype is the present British system, with part of the basic industries and foreign trade nationalized, prices, wages, and investment subject to direct controls, and some consumer rationing. Professor Haberler is much less explicit about the particular form of capitalism with which he wants to contrast planning. From the context of his paper I take it that he does not think of pure *laissez faire,* but of a free market system hedged in by monetary and fiscal controls, a system I would like to call 'reform capitalism'. But he has not told us anything about the degree of monopoly and of other rigidities and specificities that prevail in his capitalist model. We certainly need to be quite definite about these features, if only to avoid the useless pastime of comparing some ideal textbook form of capitalism with the hard facts of planning.

This leads me to another distinction I would like to throw into more definite relief than did Professor Haberler. I would like to call it the distinction between the 'functional' and the 'sociological' issues connected with our problem.

Owing to different institutional arrangements, for instance property ownership, and to different forms of control over "endogenous variables", to use Professor Smithies' phrase, reform capitalism and semi-collectivism differ in certain structural principles. This difference affects entrepreneurial and other behavior and leads to rather divergent 'rules of the game'. Now it seems to me that our primary question as economists must be: which of the two rules of the game, *if properly applied,* is more conducive to economic stabilization?

Of course, such a purely functional analysis can clarify no more than certain possibilities. To what extent these possibilities materialize in reality will depend on the intellectual, emotional, and moral climate of the society in question. To study this climate is certainly an important task, but one that should be kept apart from the functional analysis. As a matter of fact, I do not think that this second task can be pursued with much benefit before the functional problems have been clarified. And it might even be doubted whether the economist *qua* economist has much to contribute to the solution of these sociological issues. At any rate, since Professor Haberler has devoted much space to the sociological difficulties connected with planning, I propose to supplement his exposition by some comments on the functional issues.

2 THE CYCLICAL PROCESS

In turning to the substance of Professor Haberler's paper, I note, as did Professor Bergson, one essential concession to planning. He has adduced convincing reasons why planning should be more successful in dealing with cumulative movements, and especially with the secondary deflation, than reform capitalism can be. Since we probably all agree that from the practical point of view the dangers of the secondary deflation far exceed the damages caused by the primary distortion, the case seems almost settled in favor of planning. But I would like to shift the balance even further in that direction. Contrary to Professor Haberler, I believe that the functional principles of planning permit also some preventive action against the primary distortion, and that they even facilitate the rectification of maladjustments, should such maladjustments arise.

Now I agree with Professor Haberler that, lacking sufficient empirical knowledge, we can decide this issue for the time being only with the help of business cycle theory. However, I have three reservations against the procedure he has applied in this respect.

He begins with a catalogue of what he regards as the major causes of the business cycle under capitalism: innovations, wars, capital depth, expectations, credit policy, and fluctuations in the propensity to consume. I do not think — and here lies my first reservation — that this catalogue is complete. And the causal factors omitted seem to me particularly susceptible to planned intervention.

He then describes the general mechanism of response these stimuli provoke under capitalist conditions. He proceeds finally to the study of comparable responses under planning. Here my second reservation arises: Professor Haberler has failed to carry through his program to the full. He confines himself to studying the difference planning makes if war and innovations disturb equilibrium. But he has not told us anything of the effect planned intervention can have on expectations or credit policy or the other factors on his original list.

However — and this is my third reservation — even with regard to wars and innovations, he has not revealed any systematic grounds for his verdict. To do this he would have to make explicit what I called above the structural principles of planning, so that the impact of the cyclical stimuli on these principles can be demonstrated, and vice versa. More generally expressed, I do not think that the functional problems of stability in a planned economy can be solved except in the context of a dynamic theory of the various types of collectivism.

What this means concretely can be shown by reference to a passage in Professor Haberler's paper. "Investment is governed by the profit motive and expectations. If investment were carried on according to long-run objectives, irrespective of short-term fluctuations in output, the situation would be entirely different." Now there seems to me general agreement in modern welfare economics that a collectivist system can afford to do just this: (1) give precedence to long-run over short-run objectives, especially in adjusting factor prices and in bringing about compatibility of investment decisions, and (2) solve conflicts between profit maximization and maximization of social benefits in favor of the latter.

I admit that we do not as yet possess a fully worked out dynamic theory of collectivism. But I am afraid that this will impose upon us great caution in stating general propositions. What we can do is to formulate some of the problems, relevant in our context, that such a theory would have to answer. Just to indicate the nature of these problems, I shall enumerate a few, and I choose them in regard to those cyclical stimuli Professor Haberler has not himself discussed.

I refer first to expectations as an essential case where the long-run view of planning might well be able to check the rise of primary distortions. Speaking, on the one hand, of the nationalized sector, we would probably all agree that homogeneity and publicity of investment decisions should do away with numerous uncertainties that arise under capitalist conditions. This in itself should greatly reduce the range of 'free floating' expectations in the rest of the economy. Moreover, it should neutralize the 'Aftalion effect', that is, it should avoid those forms of erroneous over-investment which arise under capitalism owing to the long gestation period typical of basic industries.

In the free sector, on the other hand, wage control geared to long period considerations should have a similar effect in precluding false expectations. In particular, it should remove the typical wage lag in the early stages of the upswing, which, under capitalism, is generally held to be a main cause of the dangerous boom optimism.

To quote an instance where planning could give precedence to considerations of social benefit over those of profit maximization, I mention certain problems of credit policy. We all agree that to prevent a secondary deflation we have to maintain the aggregate volume of credit. I wonder how, in view of lenders' risk, this can really be done without some form of nationalization of credit. Moreover can credit policy be effective at all without complementary investment control, in view of the wide range of 'self-financing' in modern capitalism?

When speaking about the dangers of capital depth, Professor Haberler thinks primarily of the operation of the acceleration principle. No less important seems to me the concomitant effect of increasing indivisibilities, effects that can properly be checked only through nationalization when, irrespective of losses, output can be adjusted to the point of equality between price and marginal cost.

I said before that Professor Haberler's catalogue of cyclical causes was incomplete. I have in mind, for example, the *"periodic exhaustion of investment opportunities"* which looms so prominently in Professor Hansen's writings. Obviously, this is a constellation in which investment planning offers the only opportunity for preventing a downturn. The issue is probably of great practical importance if we think of the future of foreign investment. Governmental export of capital may well become the only effective means of reopening the international frontier.

Another example is the case of underconsumption. The discussion of Professor Gordon's paper has shown that this factor may have played an important role in shaping the economic process in this country during the '20's, especially in the form of forced underconsumption due to a cyclical shift in income distribution. Wage control, which keeps aggregate payrolls in line with output, coupled with measures to counteract the hoarding of profits, might well prevent a repetition of this particular distortion.

What I have said so far is mainly a supplement to Professor Haberler's exposition. However, I am not even quite convinced by the arguments against planning which he has expressly stated. They refer to the cyclical effects of wars and innovations. What he is concerned about in both cases is "bunched investment". Because of the acceleration effect, he sees a dilemma equally insoluble in capitalism and in planning. If we stagger investment, we deprive consumers of the speedy satisfaction of their wants; if we permit investment to bunch, we run into a depression when the new equipment is constructed, and all the capital goods industries have to fall back on is replacement.

Professor Bergson has already given one answer to this problem. I would like to add another. The dilemma does exist in the extreme cases of a war or a revolutionary innovation that affects most sectors of the economy. Even then we have under planning at least a choice, whereas under capitalism there seems to be no alternative to bunching and subsequent distortion. However, and this is more important, the dilemma loses much of its sharpness in the case of normal innovations. They can, as a rule, be carried through with the normal rate of capital growth plus the redirection of replacements. If full employment were once established on a stable basis, investment control should certainly be able to deal with the normal bunching problem.

I would like to conclude this section with a brief word on the problem of rectifying maladjustments if they should arise after all. I want to be quite explicit as to what I mean by maladjustment. The typical case and the one Professor Haberler has in mind is an over-investment distortion of the

Wicksell-Hayek type. There, in the boom, a disproportion arises between the structure of production and the structure of expenditure which can be rectified only by an adjustment of the structure of production, that is to say, by a physical shift of factors. Just in passing, I would like to say that no such problem arises in an underconsumption distortion. There equilibrium can be restored by changing the structure of income and expenditure without any physical shifts.

But if such shifts should become necessary, I cannot see that a planned economy is functionally at a disadvantage. Where monopolies obstruct the shift, planning should be able to deal with the obstacle more effectively than capitalism. Where, on the other hand, the fear of losses prevents capitalist entrepreneurs from fixing their output at the point of the social optimum, nationalized industries would certainly do better.

3 SOME SOCIOLOGICAL CONDITIONS

I now want to come back to what I said at the beginning. I do believe that, as far as stability is concerned, the functional mechanism of planning is superior to that of reform capitalism. But even if the functional mechanism of planning were perfect, the practical results would depend on the environmental conditions that determine the degree to which it can be effectively utilized. With this we can enter the wide and little explored field of economic sociology.

Among the vast array of sociological problems every economic system has to solve, the following three seem to me essential in our context: the capacity to forecast or, in the case of planning, more precisely the capacity to diagnose the beginning of dangerous lags and amplitudes; the efficiency of managerial personnel; the distortion of the proper functional behavior by politics. Compared with a truly competitive capitalism, planning is probably at a disadvantage on all three scores. But is competitive capitalism the practical alternative? Is not the real alternative a semi-monopolistic system, burdened with large indivisibilities and specificities, and dominated by pressure groups?

This alternative changes the score radically. Are we really all convinced that United States Steel is run more efficiently than TVA? It certainly has not shown better foresight than the government planners in recent years. Contrary to Professor Haberler's assertion, there is no practical conflict between the steel industry and the federal government over the expansion of steel capacities. In spite of verbal protests, the steel industry during the last few years has done precisely what the government wanted it to do — expand. The future will show whether this was a good policy. But good or bad, it was the policy of both parties.

But the crucial issue is what kind of economic policy can effectively stabilize American capitalism. Professor Haberler is in favor of purely fiscal and monetary controls, hoping that in this way at least the violent fluctuations of the cycle can be ironed out. It would certainly be unfair to judge the effectiveness of compensatory fiscal devices by the experience of the 1930's. But the last fifteen years have clearly pointed up the social forces that may in the future obstruct any such measures: the unholy triad of business, farmer, and labor monopoly, and the danger of a private investment strike so long as business has not become reconciled with the fiscal policy of the 'welfare state'.

Few would subscribe today to Lord Keynes' dictum that reductions of real wages, as a consequence of reflation, are not resisted by the workers unless they proceed to an extreme degree. In other words, no one knows where the 'point of acquiescence' lies beyond which American labor will force up money wages. And I see no reason for Professor Fellner's optimism, expressed in his excellent contribution to Professor Ellis' Survey, that this might not happen "at thoroughly unsatisfactory levels of aggregate output and employment".

All this is not to claim that we have today at our disposal every scientific instrument necessary for a planning policy that goes beyond fiscal controls. Therefore my practical conclusion for the year 1949 is not so very different from that drawn by Professor Haberler. But because of the serious doubts I have about the efficacy of purely fiscal controls, I regard this discussion as far from closed.

DAVID McCORD WRIGHT, *University of Virginia*

Economists who maintain that a socialist or a comprehensively planned economy will not necessarily eliminate forces making for cyclical swings are likely to be misunderstood in two ways:

First, it may be thought that they believe socialism *could* not eliminate the cycle. This is wrong. In my *Economics of Disturbance* (Macmillan, 1947), for example, I merely maintained that the 'over'-building of the capital goods industries in connection with the backlog (or frontlog) difficulty could not always be eliminated *if* we wanted to give the consumer *what* he wanted *when* he wanted it.[1] There is thus a certain residual conflict

[1] Especially Chapter V, The Business Cycle Planned Case. The reader is referred to the text for the necessary qualifications. By 'frontlog' I mean difficulties concerning the rate of expansion created *ex ante* by a massive invention or shift in wants. Mr. Bergson is correct in stating that new inventions and displacements *could* come at offsetting rates, but he has adduced no evidence to show that they are obliged to do so *spontaneously*. Of course the establishment of a central licensing board to hold back change to the "proper time" could *force* a smooth aggregate. Cf. Bergson, *loc. cit.*, pp. 438-9.

of *values* that sometimes lies beyond institutional organization and has no relation to 'errors' of planning.

Secondly, it may be supposed that we maintain that 'large scale unemployment' is inevitable even under socialism because of the backlog difficulty.[2] This too is inaccurate. As I wrote in *Economics of Disturbance,* "the inevitable discontinuities of rapid capitalist growth would remain inevitable [in the circumstances assumed] in rapid socialist growth, but during the interval between bursts, *the planners could organize various social desires for durable goods to fill in the gap.*"[3] Deficit finance and public works are no monopoly of capitalism.

But the question can be asked: Why would it not be better to get the consumer to wait a little and require the inventor to wait a little, and thus 'smooth out' capital installation? The mathematical logic of such suggestions is impeccable.

I, however, object on social and politico-economic grounds. First, even if a smooth aggregate is obtained, the process of growth *per se* will still cause unsymmetrical shifts in the pattern of wants and techniques.[4] Thus even socialism could not give security in *unbroken occupational routine.*[5]

But second, in a security-conscious population the central planning board would be the target for so much pressure group resistance from occupational vested interests as to be likely in a liberal society to induce an industrial stalemate. Also its control over the future development of all economic units would give it immense indirect political power to influence elections. These points are explained in my *Democracy and Progress* (Macmillan, 1948).

Thus I would prefer to handle the discontinuities of investment demand, which seem to me inevitable from time to time in a developing free market, by the conceptually less tidy but politically safer method of compensation plus measures to stimulate private investment, rather than *ex ante* direction.

One final question may be raised: What about the element of *repetition* which the word 'cycle' implies? It may, for example, be said that occasional 'over'-expansions of investment, or pressures toward them, could occur, but that they would not take a 'cyclical' form. I have grave doubts whether

[2] *Ibid.,* "it is difficult to see why there should be mass unemployment *which Wright would expect.*" This statement is, of course, a misunderstanding of my position. See passages cited in the text and below, note 3.

[3] Wright, *op. cit.,* pp. 86, 97.

[4] See *ibid.,* Chapter III, and, for a sample of statistical data, Income Sensitivity of Consumption Expenditure, *Survey of Current Business,* January 1950, p. 17.

[5] And since reorganization of methods involves a reorganization of power and prestige structures, great psychological insecurity could survive. See D. Krech and R. S. Crutchfield, *Theory and Problems of Social Psychology* (McGraw-Hill, 1948). p. 540.

the cycle — in the sense of an iron, mechanically imposed rhythm — actually exists. But irregular 'waves' under socialism seem perfectly possible. Theoretically, of course, these would be eliminated, but theoretically one can also give a beautiful explanation of how the market mechanism would eliminate disturbance. *Practically speaking,* it seems to me just as possible for cumulative disturbance under socialism to begin to exhibit fragments of apparently rhythmic pattern as for the same thing to occur under capitalism.[6]

[6] Professor Haberler has suggested waves of optimism and pessimism, but a 'reaction-time' theory *à la* Pigou would also be appropriate, and there could be many other sources of recurrent irregularity amid which an ardent seeker for regularities could 'isolate cycles'. May one not perhaps see traces of such a pattern of inflation-followed-by-devaluation emerging in Russia?

N. I. STONE, *New York City*

In speaking of the Soviet planned economy, Professor Bergson remarked that the USSR has had no business cycles, by which, I presume, he meant that Soviet Russia has had no unemployment.

As a statement of fact it is perfectly true. But if it implies that Soviet Russia has solved the problem of the business cycle through planning, I would take issue with that statement.

Soviet planning has been so poor that the government-controlled press is full of complaints about frequent shutdowns of manufacturing plants for lack of raw materials and consequent layoffs of workers. There is extremely bad coordination among industries that depend on one another for their materials or parts. It is a common occurrence for plant managers to be dismissed, indicted, and sentenced to jail or forced labor camps for failure to fulfill impossible tasks laid down by the planners in Moscow.

Yet it is perfectly true that there are no cyclical booms and depressions in Soviet Russia. The reason is very simple: the USSR has been maintaining a war economy for the entire thirty-odd years of its existence. A war economy is a glutton for labor. Hitler did away with unemployment soon after his advent to power by starting intensive preparations for war. Our own unplanned, uncontrolled free enterprise economy soaked up all the available labor in 1916-18 and 1939-45 when it was first arming for and then waging war. Whether Soviet Russia will be able to eliminate cyclical fluctuations in its economy remains to be seen when it ceases its feverish preparations for war and disbands its huge armed forces.

CYCLES IN A PLANNED ECONOMY

EVSEY D. DOMAR, *The Johns Hopkins University*

I am in complete agreement with Professor Bergson who has not found any business cycles, in the usual sense of the term, in a planned economy like that of the Soviet Union. The essence of our business cycles lies not in the initial disturbance, whatever its origin may be, but in the vastly magnified secondary effects. And it is rather unlikely that, in a planned economy, the latter will be allowed to spread.

This is not to say that socialist planners will be omnipotent. If they do a better job in some respects, such as in the field of economic stability, their performance may be inferior in others. One may say, and not without foundation, that a socialist economy will have a strong tendency toward inflation, just as a capitalist economy is biased in the opposite direction. The inflationary developments we have seen in Russia and, more recently, in Britain are certainly not accidental. If a capitalist society may be compared with an airplane, whose inherent tendency is to fall down unless supported by the work of its motor, a socialist society might be likened to a ballon, which, were it not for its cables or ballast, would fly off into the air altogether.

But if a planned society is not likely to have business cycles, does that mean that its study is irrelevant for our purposes? I certainly do not think so. The study of a socialist society can be extremely useful as an analytical device which makes certain variables approach their limits. We do it frequently in economic theory when we make time approach infinity, or an interest rate or a rate of growth approach zero, not because we actually expect these events to take place, but because such a procedure gives us a better understanding of the behavior of these variables and of their interrelationships. Similarly, a study of a socialist society can indicate what happens to a capitalist economy when certain of its variables, so to speak, are allowed to approach their limits. Such a study should be extremely useful for the understanding of our own economy.

The study of a planned society such as that of Soviet Russia can also be used as a test of the universality of our economic ideas and as a source of new ones. It is not an accident that a large number of new ideas appeared during the '30's. The great depression brought about a general re-examination of our intellectual equipment, and the outcome has been striking. A similar process is taking place today as a result of the last war. But these are rather expensive methods of obtaining new ideas, and a study of economies different from our own can be at least a partial substitute.

REPLY BY MR. HABERLER

I have very little to say in comment on the interesting remarks by Professor Bergson. I did not deal with planned economies of the Russian type because (a) I do not know much about Russia and (b) I took it for granted that in such an economy there would be nothing resembling the business cycle as we know it in capitalistic economies. There may be, and evidently there actually are or were — occasionally on a gigantic scale — waste, starvation, and open or disguised unemployment resulting from faulty coordination — frictional unemployment we would call it in our economy — but no cumulative, self-reinforcing swings which are the essence of the capitalist trade cycle.

Professor Bergson says that I did not comment on the case considered by Professor Wright where maladjustments arise because the capacity required to build up stocks of durable goods exceeds that required to maintain these stocks after they have been built up. I agree, I should have referred to Wright; but I did have that case in mind. Bunched investment due to the accumulation of backlogs in a war, or bunched investment due to the Schumpeterian mechanism of innovation, leads to setbacks precisely for the reason that replacement demand does not step smoothly into the breach left by the falling off of new investment. In many cases, it is true, we can imagine new investment spaced in such a way over time that replacement requirements compensate for the lack of new investment.[1] Professor Hayek, however, is much too optimistic in assuming that this is always practicable. Wright is quite correct, it seems to me, in saying that "the backlog . . . difficulty could not always be eliminated *if* we wanted to give the consumer *what* he wanted *when* he wanted it." If the capital goods are very durable, proper spacing of investment evidently becomes impossible. Suppose ballpoint pens were literally perpetual as the advertisements want us to believe; then once the population has been supplied with such pens, there would be no replacement, and demand for pens would fall to zero (or to the level required to replace lost pens and to supply new entrants into the market with new pens). This is, of course, an extreme example, but the difficulties remain the same, in principle though not in degree, if the assumptions are relaxed.[2]

Let me now make a few remarks on Professor Lowe's comments. He

[1] Frisch, in his controversy with Hansen and Clark, as well as Hayek have commented on that possibility. F. A. Hayek, Capital and Industrial Fluctuations, *Econometrica,* II, 1934, reprinted in his *Prices and Production,* 2d ed. (Routledge, 1935).

[2] The matter is further discussed in my *Prosperity and Depression* (3d ed., League of Nations, 1941, Ch. 13) and in my *Consumer Instalment Credit and Economic Fluctuations* (NBER, 1942).

wants to know what kind of capitalism I propose to compare with the type of planning I have been discussing and suggests that we should not compare "some ideal textbook form of capitalism with the hard facts of planning". For the last hundred years or more the opposite mistake has been made. Since there were no examples of planned economies readily available, in practically all discussions an ideal type was substituted for the real thing. Thus perfect planning was compared with the type of capitalism that actually existed — which, of course, for many reasons (last but not least for the reason that it was always subject to misguided state intervention) deviated from the ideal type. We certainly should avoid the mistake of falling into the opposite extreme. I thought, however, that it was not necessary to specify any special type of capitalism, because the business cycle has persisted for the last two hundred years or so under rather different degrees of monopolization of industry, different types and degrees of labor organization, different monetary and fiscal policies, and so on and so forth. Whether a high degree of monopolization is likely to accentuate or to mitigate the cycle seems to me one of the unsettled questions of business cycle theory. I am not in a position to give a definite answer, but my impression is that the degree of monopoly, at least within a wide range, is of minor importance.

The question of price rigidity should be separated from the question of monopoly. A monopoly price need not be a rigid price. The question whether price rigidity is conducive or not to stability has been much discussed. It would lead too far afield to discuss those controversies, since no simple answer can be given. So much seems to me certain, however — unemployment equilibrium is incompatible with price flexibility. Most modern business cycle theories (especially all neo-Keynesian theories) assume constant or at least highly rigid prices, and the discussion of what would happen in their models if prices and wages were flexible is highly unsatisfactory and inconclusive.

Professor Lowe wishes to distinguish between 'functional' and 'sociological' issues connected with our problem. I am not quite clear what he means by that distinction but it seems to me that by 'functional' he means ideal conditions while the 'hard facts' of planning are called 'sociological'. This interpretation accords with his finding that 'functionally' planning is superior to capitalism while 'sociologically' planning is probably at a 'disadvantage' if it is compared with competitive capitalism, though actual capitalism shot through with monopolistic elements and rigidities is again a different matter.

'Functionally', Professor Lowe says, a planned economy is in a good position to prevent certain "major causes of the business cycle under capitalism" which I have *not* mentioned. A little later he mentions two such causes which I have omitted. The first is "periodic exhaustion of investment opportunities". The fact is, however, that I did mention this possibility. It heads my list of "factors bringing about the end of a cyclical upswing": "Investment opportunities may *temporarily* be exhausted and it may take time before new ones are developed."

The question remains whether a planned economy would be in a better position to deal with such a situation. My answer was that a planned economy can speedily find offsetting expenditures whenever investment opportunities in any particular line or industry are exhausted. But I still believe that there is no warrant for the assumption that overinvestment in any particular field will always be avoided. Professor Lowe says that I have not given any "systematic grounds for that verdict." I doubt whether "systematic grounds" can be given. I would rely in such matters on experience. And the evidence I cited seems to point in the direction that I indicated. Incidentally, Professor Lowe is, I believe, mistaken in what he says about U. S. Steel capacity. The steel industry had always planned to expand capacity but refused to expand as far and as fast as government planners thought it should.

Another cause of trouble, which according to Professor Lowe I have omitted from my list, is *underconsumption.* This he says is a type of difficulty a planned economy can easily cope with. I think the same is true of what Professor Lowe calls 'reform capitalism', i.e., a free enterprise economy with vigorous counter-cyclical monetary and fiscal policy. Nothing is easier and more pleasant than to stimulate consumption by public works, bonuses, tax remission, etc. I doubt, however, whether genuine underconsumption is frequently at the root of a cyclical downturn. On the other hand, once a cumulative process of deflation has started, underconsumption plays its role: there is then underconsumption (as well as underinvestment) — let us call it underspending, another word for deflation. But this is a different matter altogether.

Professor Lowe speaks of the "typical case" of maladjustment which he says I have in mind, namely "over-investment distortion of the Wicksell-Hayek type". I do not believe it is correct to mention Wicksell and Hayek together in that connection. Hayek was greatly influenced by Wicksell's theory but I do not think one can find in Wicksell's writing a description of the type of maladjustment Hayek envisages. Moreover, I did not refer to that kind of maladjustment nor did I have it in mind. I said that it was easy to see that when a boom hits the ceiling of full employment it would not stay there but would be thrown into a depression. I thereby referred to the kind of maladjustment I had tried to describe at some length in my *Prosperity and Depression* (3d ed., pp. 361 ff. and pp. 503 ff.). The same type of difficulty was, I think, envisaged by Harrod in his *Trade Cycle* and has recently been made a cornerstone of Hicks' cyclical model (*A Contribution to the Theory of the Trade Cycle*).

I agree with Professor Lowe that the effectiveness of compensatory fiscal policy should not be judged by the experiences of the 1930's for the reasons that it was not very vigorous and that fiscal policy, i.e., spending policy, was accompanied and largely offset in its effects on employment by a contradictory policy of raising costs (NRA and labor policy). I agree also that with aggressive labor unions any full employment policy is always in danger of creating inflationary conditions. But I cannot take seriously "the danger of a private investment strike". There seems to me not the slightest indication in the experience of the last 20 years that such a thing has happened.

This is a matter somewhat removed from the subject of my paper and I beg, therefore, to be excused from going into it more thoroughly.