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Volume Author/Editor: John Maurice Clark

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Chapter Author: John Maurice Clark

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PART FOUR

SPECIAL FEATURES OF THE LAST CYCLE

Summary

MOST of the distinguishing features of the last cycle have already been indicated in the course of the discussion. There was the world-wide decline in prices, the beginnings of which were visible before the general decline in American business began, and which continued and grew serious hand in hand with the progress of the general business recession. There was the behavior of our export trade, which showed a strongly marked cycle in harmony with our own, and which took the lead on the decline—both features being peculiar to this cycle. There was the concentration of expansion upon securities rather than mainly upon goods, culminating in the mad boom in the stock market and the resulting violent collapse, together with the continuance of the boom past the peak of general business instead of taking the lead on the down-turn, as usual. There was the peculiar behavior of construction. There was the depression of agriculture which prevailed before the general business recession and became deeper. There was the attempt to sustain construction and capital expansion by the method of conference and voluntary action—an attempt which did not prevent heavy declines. There were the attempts to resist the decline of money wage rates and to sustain the prices of leading agricultural products by buying and holding the surplus. And there was the fiscal and monetary crisis in various foreign countries, coming to a head at a time when the depression had already gone deeper and lasted longer than usual. There was an unusual number of bank failures, becoming increasingly prevalent and alarming as the depression lengthened, and followed or accompanied by an unusual tightening of bank credit and a wave of withdrawal and hoarding of cash, against which a determined campaign was launched, first by methods similar to those first used in the attempt to sustain capital expenditures, and later by the Emergency Credit Corporation and other tangible means.[1]

Another feature of the current cycle was the piling up of unusually large stocks of several basic com-

[1] Since the above was written the situation has been brought to a head by the general banking suspension of March, 1933.

modities, among which wheat and oil stood conspicuous but by no means alone. Ordinarily, literal over-production as evidenced by the actual piling up of stocks is a relatively small factor in the cycle, and only appears after recession has set in. In this case, there were some significant increases before the down-turn in general business; and the stocks of a number of basic materials ultimately accumulated appeared unusually and alarmingly large.

Another feature has been the unusually large part played by consumption goods in the decline; the decrease in their production has been great and began before that in other industries. Passenger automobiles were apparently the dominant factor in this movement, at least in the earlier stages. This suggests that we have an added problem to face in the relative increase of durable consumers' goods, new purchases of which at any given time are not in the class of necessities but are highly postponable or optional. Inventories in the hands of consumers thus come to be more and more important; and we must expect that an increasing length of time must elapse before these inventories will be worn down to a point at which new purchases will be required if the consumer is to go on consuming. Though sales of automobiles fell off enormously, it was not until 1931 that they fell clearly below what may be taken as a normal replacement basis; thus indicating an actual decrease in the number of normally effective cars in the hands of users; and even that did not mean that the gross number of cars of all ages was decreasing.

A cursory survey of conditions tends to the conclusion that practically all possible factors conspired to do their worst in the present depression; especially the non-cyclical factors which appear to have marked this as a phase of post-War dislocation even more than a cyclical decline. There are, it is true, some puzzles to confront in any such diagnosis. Construction, contrary to custom, was declining almost throughout the up-swing of general business; while stock exchange speculation, also contrary to custom, continued to rise until after the beginning of general recession. If one of these was an unfavorable condition, was the other favorable? And if both were unfavorable, how is this to be explained?

Probably the truth is that the particular timing of these movements was not of so much importance, especially as they tended to offset each other, as the fact that both had gone beyond the usual degree of expansion characterizing a typical cyclical up-swing. The impetus from the speeding-up of construction incident to making good the War-time shortage was not exhausted in one cycle, and was prolonged by the further stimulus of speculative building. And as to the stock market, the continued rise in paper values after the underlying productive processes had slowed up caused in itself an unusual and unbalanced condition, tending to make the final crash worse. It meant to a considerable extent that the usual adjustments to a slowing-up of production were not made at the usual time.

Stock prices during the great boom were capitalizing not current earnings but future increases of a sort which any systematic analysis should have revealed as beyond all human possibility. The only other justification for such values would have been a radical and enduring reduction of interest rates. But this should have affected stocks and bonds alike, and the rates on bonds and mortgages prevailing at the same time showed no such radical decline as would have been needed to rationalize the prices of stocks. What was happening was a relative shift of demand, in favor of speculative securities, out of all proportion to the magnitude of ordinary shifts of this sort, carrying values, relative to yields, to points far outside what could be called normal, unless on the basis of an expectation of future increase which no industrial system could maintain. A person who appreciated this fact might still have bought stocks in the hope that the craze would last long enough to enable him to sell out at a profit, leaving some other purchaser to bear the inevitable disillusionment; but this psychology of 'after us the deluge' was not the one which actually prevailed, and it could hardly have accounted for the extravagant lengths to which the boom was carried. Buyers who thought of the matter at all were typically convinced that the country had entered upon a 'new era' in which deluges were not to be permitted.

Non-Cyclical Factors: Post-War Conditions

The current depression is more than the end of a business cycle of unusual severity. On the basis of cyclical theory limited to the hypothesis of the type of cycle averaging in this country three and a third years, it is impossible fully to explain all its characteristics—its small rise, enormous decline and long-continued period of prostration. In part it may furnish evidence, of a provisional sort, of the combination of the shorter cycles with a longer cycle of about three times the average duration of the shorter ones. This longer cycle appears to rest in considerable part on the psychology of speculation, and on the related factors of expansion of fixed capital and of construction.

But these factors are themselves not unrelated to another set of factors which are not cyclical at all in any discoverable fashion: namely, the process of post-War reconstruction and the dislocated conditions of international finance and trade, which the War left behind it. One legacy of the War was a price structure which, even in 1921, had presumably not completed its destined deflation. In this country, prices were still well above the pre-War level, while the world at large had not returned to the gold basis. Along with this went a mal-distribution of the world's gold supply which left this country with ample gold to sustain the post-War price level without straining its credit machinery, while other countries lacked a gold basis adequate to the requirements that would be set up by resumption of specie payment. As country after country resumed specie payment, they took up the burden of sustaining a volume of media of exchange adequate to the current price level on a scant gold basis. Thus the price level rested on an insecure foundation, and what might be called the normal deflation was postponed. Any tendency to downward movements in prices was further blocked at numerous points by specific measures for sustaining the prices of numerous particular commodities. This entire situation meant weak currency and credit structures, which must be protected against large gold movements; while gold movements were called for by the War's legacy of economically abnormal debts and the impossibility of paying them in commodities. Palliatives such as short-time borrowing increased the instability.

The result would have been to strip Europe of gold completely, had it not been for a great flow of loans from this country—a movement which in the nature of the case could not go on forever. This we can now see, though no one could predict in advance when or how the end would come. The case was not like the former borrowings of the United

States from Europe: borrowings which furnished capital needed for the development of a virgin continent into the most productive area of the world. These new loans back to Europe were made to a weakened economy, in amounts beyond what was directly productive. They were made by a country unwilling to do what Europe had done when it was our creditor: namely, accept payment in goods. Thus there was doubt whether debtor economies would bear the aggregate debt charges in addition to their other burdens, and certainty that the creditor country would not accept real repayment if it could be made. The movement of European funds into the American stock market, lured by the boom, was an aggravating circumstance. Ultimately the price structure broke and a catastrophic fall in world prices followed. Later, credit structures also collapsed, having been further weakened by the piling up of perilously large volumes of international short-term obligations. Thus pressures accumulated through a period of years, and finally came to a head.

For the United States the post-War export of capital postponed for at least ten years the impact of the new position of a creditor country in which the War left us. To this new position we have not yet begun to adjust our economy, or manifested any real appreciation of the nature of the necessary adjustments or any willingness to make them. We continued apparently determined to go on selling goods abroad and unwilling to receive in return goods which competed with our own products. And now we stand helplessly contemplating the collapse of this system and unable to face in any new direction. Our tariff on competitive goods is nearly prohibitive, and two-thirds of our imports consist of those non-competitive goods which are left on the free list. Under these conditions Europe can manifestly not continue to take our products in the volume essential to our existing plan of prosperity; but with this fact we have not yet made our reckoning. This represents a non-cyclical factor of vast importance, both for the present and for the future.

Increase of Durable Goods

Another factor in the present situation, bearing not merely on the existing crisis but also on the probable character of future cycles, is the outcome of our rising standard of living and especially the increasing importance of durable consumers' goods. As we have already seen, these changes result in a great relative increase in the volume of purchases which are optional and to a high degree postponable, and hence peculiarly sensitive to changes in the flow of current incomes and in the general state of confidence.

A further complication is the fact that such purchases are largely made on credit—indeed, the volume of credit used to finance such purchases appears to have been increasing faster than the volume of this class of purchases, indicating an intensified increase in the resort to credit.[2] This credit is of a longer-term sort than retailers' current accounts, and is highly expansible because it is based on the specific security of the particular goods bought. And while credit may be more a passive and enabling force than an active and initiating one, it is still crucially important.

Any class of purchases made on this sort of credit is one in which it is possible for current purchases to move more or less independently of the volume of current income derived from past acts of production, and we have seen that durable goods are by their nature predisposed to just such movements. Such movements have a peculiar power to *initiate changes in the rate of production.* This they could not do if purchases must always equal income; income in turn being made up of the financial proceeds of *past acts of production.* Once initiated, changes in production return in the familiar cumulative fashion to cause further changes in purchases. Thus goods of this sort, bought in this way, are a peculiarly disturbing element in our economic life. And because this element is increasing, it may well

[2] This statement is based on a study of construction made for the National Bureau of Economic Research, in cooperation with the Committee on Recent Economic Changes, by W. C. Clark and Miss Victoria Pederson; and on the growth of installment selling as reported in unpublished studies made for the National Bureau.

be that, if no effective means of stabilization are found, business cycles in this country are destined to become progressively more severe in the future.

In this connection there is also the possibility that the increasing volume of durable goods may lengthen the time required for the using-up of inventories in the hands of consumers, and thus cause one of the forces of recovery to act more slowly. As a further result of longer periods of subnormal production, there may be more work to do, upon the revival of demand, to bring supplies up to a prosperity normal. The resulting expansion in these industries may be either more violent or more prolonged, depending on how rapidly they can expand their output. The outcome may take one of several forms: (1) more violent expansions of general business, (2) more prolonged expansions of general business, or (3) expansions in these special industries lasting over more than one short cycle of general business, as the post-War construction boom did, thus tending toward an alternation of mild and severe cycles. Possibly all three effects might appear at different times, according to the special conditions prevailing.

Conditions Bearing on Recovery

The study of the special features of the present depression seems to indicate that it may have extended past the point at which some of the usual forces of automatic recovery can be expected to come into operation, largely because consumers' reserves became exhausted, while there was still a large surplus of construction and capital equipment relative to the shrunken volume of purchasing power. As a result, the prospect of recovery through the usual automatic forces was no longer extremely hopeful, and a search for more powerful and positive measures was urgently indicated.

On the other hand, the trough of the depression witnessed widespread hoarding, an abnormal restriction of credit—abnormal even for a depression—and a condition approaching panic on the part of banks even before the general suspension of March, 1933.[3] All this gives some ground for hope that if these conditions can be overcome and an upward movement once started, it may have cumulative effects of the usual sort, and may even initiate the chain of causes leading to a recovery as complete as the new international conditions make possible. These new international conditions, however, act as a bar to the hope that we may quickly catch up with the trend of 1922-29 and continue on a prolongation of that upward movement. We cannot continue indefinitely to finance a large export surplus with loans

[3] This and the following paragraph were originally written before the inauguration of President Roosevelt and the general banking suspension of March, 1933. The final opportunity for revision comes as the Roosevelt recovery program is getting under way but too soon for any considered estimate of its results. Therefore the original statements have been allowed to remain.

over and above the debt payments due us, and thus maintain our industry in the happy state of working both for the foreign and the domestic markets. That particular vein of prosperity appears to be worked out. Hence it seems highly improbable that the next revival will reach the heights of 1928-29, whatever may ultimately happen.

One further consequence of serious moment follows. Improvements in technique have been installed, or stand ready to be installed, which will still further economize labor, and if total output does not reach the level of the former peak, the next revival cannot restore more than a part of the employment which the present depression took away. We shall have a large unemployment problem in the winter of 1933-34, and the following winter, even if revival follows upon the efforts of the Roosevelt administration and goes as far as any rational forecast can conceive. This means that, even while we face the immediate pressure to feed and shelter the needy, and relegate 'long-range planning' to an indefinite future, planning of an intermediate sort is pertinent, practical and almost necessary: planning for one, two and three years ahead. For example, a coordination and extension of present local and fragmentary schemes for enabling the otherwise unemployed to produce for their own and one another's needs under a system of barter or other interchange: this might be a most practical undertaking.