CHAPTER IX: Some General Remarks

SECTION A: THE ECONOMIC FUNCTION OF THE TRADE CYCLE.

Let us ask what economic function, if any, was performed by this continuing series of violent oscillations of the economic system of the nineteenth century. One might think (and many people, then and now, do think) that it should be much better to have a smoother-running system, not subject to such dreadful cataclysms every nine or ten years.

We would like to suggest that this conclusion is by no means certain. If regularity of operation of the economic system (the usual term is "stabilization") is all that is wanted, then there exist many historical instances of "stable" economic systems for our inspection. Indeed, for thousands upon thousands of years of recorded human history, economic change is exceedingly slow, almost invisible on the scale of a human life. Only wars and natural disasters produce any changes in such essentially static economies.

For a particularly instructive comparison, consider eighteenth century France and eighteenth century Britain. In France, the panic of 1720, resulting from the "Mississippi bubble" of John Law, was remembered throughout the century with vivid horror. The authoritarian government of the ancien regime made sure that such a thing could not happen again. Speculation was controlled tightly, so no successors to John Law could arise. By contrast, eighteenth century Britain was, for long periods on end, controlled by a Whig government friendly to commercial interests. Speculation was not encouraged, but neither was it forbidden.

The results from these opposite policies were striking. In Britain, there was a series of ups and downs, with "panics" at more or less regular intervals. The British economy was "unstable", but on a secular scale it grew by leaps and bounds (literally!) throughout the eighteenth century. By contrast, the French economy of the ancien regime behaved in an orderly, regular and controlled fashion. No violent ups and downs, no wild booms or even wilder panics, disturbed its stately and inexorable descent into the ultimate disaster of 1789!

We conclude that "stability", by itself, should not be considered the main or ultimate goal of economic management. Stability is, all too often, merely stagnation.

It is natural to ask whether this apparent correlation between economic instability and economic progress is a complete accident, or whether perhaps the trade cycle serves a
real economic function. Our model suggests that the latter is the correct answer. Our group 1, the investors, is basically parasitical on the rest of the economy. These "investors" collect rent for land, but do not perform any significant economic service in return for these payments.

It is evident that no industrial economy can develop beyond a certain point until it possesses adequate capital goods capacity. But it is also evident that under conditions of private enterprise the extremely costly capital investment necessary for much of this development is not likely to be undertaken for the same reason as the industrialization of cotton or other consumer goods. For these a mass market already exists, at least potentially: even very primitive men wear shirts and use household equipment.

The problem is how to put a sufficiently vast market sufficiently quickly within the purview of businessmen. No such ready-made market exists, e.g., for heavy iron equipment such as girders. It only comes into existence in the course of an industrial revolution (and not always then), and those who lock up their money in the very heavy investments required even by quite modest ironworks (compared to quite large cotton-mills) before the market for their products is visibly there, are more likely to be speculators, adventurers, dreamers, or gullible fools, than to be sound businessmen.

If the investors retain their rents, hoarding them or spending them only on luxury consumption and/or war, then funds which could be used for investment and economic development are frittered away idly. From this point of view, there is a definite advantage to the economy as a whole in any scheme, no matter how unstable or fraudulent, which can persuade these investors to release some of their wealth for the purpose of real investment in productive activity.

The trade cycle, in our view, acts as such a scheme. Furthermore, we assert that the associated instability and recurring panics are a necessary element for the success of that scheme.

Let us elucidate this second point. In order to persuade the investors to invest, they have to be promised sky-high returns, and the money market must appear to bring enormous (and hence quite unrealizable) capital gains. This requirement ensures that a crash has to come sooner or later. In the crash, many investors lose their investment. The net result is a transfer of funds from the investor class to the class of industrialists, and to some elements of the general population.