
The Business Cycle

GROWTH AND CRISIS UNDER
CAPITALISM

Howard J. Sherman



PRINCETON UNIVERSITY PRESS
PRINCETON, NEW JERSEY

Contents

<i>List of Figures</i>	xv
<i>List of Tables</i>	xix
<i>Preface</i>	xxi
PART ONE: Overview	
CHAPTER 1	
The Waste of the Business Cycle	3
<i>Losses to Society</i>	4
<i>Losses to Business</i>	4
<i>Losses to Individual Workers</i>	4
<i>The Controversies and a Framework for Their Analysis</i>	5
CHAPTER 2	
Measuring the Business Cycle	7
<i>Definition of the Business Cycle</i>	7
<i>Dates of the Cycle</i>	9
<i>Reference Cycles versus Specific Cycles</i>	10
<i>Divisions of the Cycle</i>	11
<i>Cycle Relatives</i>	12
<i>Rates of Growth</i>	14
<i>Cyclical Amplitude</i>	15
<i>Leading, Lagging, and Coincident Indicators</i>	16
<i>The Business Cycle as a Unit</i>	21
<i>Appendixes for Reference to Data</i>	21
CHAPTER 3	
History of the Business Cycle	23
<i>Production for the Market</i>	24
<i>Regular Use of Money</i>	26
<i>Production for Private Profit</i>	30
<i>The Spread of the Business Cycle</i>	31
<i>Stages in U.S. Capitalism</i>	32
<i>Long-Run Changes and Regularity in the Business Cycle</i>	35
<i>Cycles in the U.S. Economy</i>	36
<i>Consumption and Investment in Three Eras</i>	40
<i>Cyclical Movements of Income</i>	42

<i>Unemployment</i>	44
<i>Conclusion</i>	48
<i>Further Reading</i>	49
CHAPTER 4	
Endogenous and Exogenous Cycle Theories	50
<i>Say's Law</i>	50
<i>Critiques and Defenses of Say's Law</i>	52
<i>Three Arguments for Say's Law</i>	53
<i>Neoclassical-Keynesian Critique of Say's Law</i>	54
<i>Post-Keynesian Critique of Say's Law</i>	55
<i>Monetarism</i>	56
<i>The New Classical Economists</i>	57
<i>Supply-Side Economics</i>	61
<i>Blaming the Victim</i>	61
<i>Neoclassical Microfoundations of Neoclassical-Keynesian Macroeconomics</i>	63
<i>Exogenous Shocks and Adjustment Barriers</i>	64
<i>Conclusions and Policy Implications of Exogenous Theories</i>	66
<i>Endogenous Theories of the Business Cycle</i>	67
<i>Demand Theories: The Multiplier-Accelerator Theory</i>	67
<i>Demand Theories: Underconsumption</i>	67
<i>Supply Theories: Real Overinvestment</i>	68
<i>Supply Theories: Monetary Overinvestment</i>	68
<i>Supply Theories: The Reserve Army</i>	69
<i>Profit Squeeze (or the Nutcracker Effect) in Marx, Mitchell, Keynes, and Kalecki</i>	69
<i>The Framework of Analysis</i>	72
<i>The Method of Successive Approximations</i>	72
<i>Appendix 4.1: Marx on Reproduction and Growth</i>	73
PART TWO: <i>The Basic Model—Demand and Supply over the Cycle</i>	
CHAPTER 5	
Consumption	83
<i>Types of Consumption</i>	83
<i>Keynes's View of Consumption</i>	84
<i>Relative Income Theory</i>	88
<i>The Life Cycle Hypothesis</i>	88
<i>The Permanent Income Hypothesis</i>	89
<i>Evaluation of Neoclassical-Keynesian Theories</i>	90
<i>The Class Income Hypothesis</i>	93
<i>Workers' and Capitalists' Propensities to Consume</i>	95

<i>Consumption and Income</i>	97
<i>Propensity to Consume and Labor Share</i>	103
<i>Consumer Credit</i>	106
<i>Government</i>	106
<i>International Trade</i>	106
<i>Conclusion</i>	107
<i>Appendix 5.1: Time Lags</i>	107
CHAPTER 6	
Investment: The Profit Hypothesis	110
<i>Consumption and Investment</i>	110
<i>The Profit Hypothesis</i>	111
<i>Competition</i>	113
<i>Expectations and Uncertainty</i>	114
<i>Demand and Sales</i>	115
<i>Cost Theories of Investment</i>	116
<i>Profit Studies</i>	117
<i>Types of Investment</i>	118
<i>Investment, Profits, and Profit Rates, 1949–1970</i>	120
<i>Investment, Profits, and Profit Rates, 1970–1982</i>	121
<i>Time Lags in the Investment Process</i>	124
<i>Timing in Different Industries</i>	126
<i>Inventory Investment</i>	128
<i>Depreciation and Replacement</i>	133
<i>Tentative Conclusions on Investment</i>	136
<i>Appendix 6.1: Investment Equations</i>	136
CHAPTER 7	
The Multiplier-Accelerator Model	138
<i>The Accelerator Relation</i>	138
<i>Limitations and Qualifications of the Accelerator</i>	141
<i>The Investment Multiplier</i>	142
<i>Qualifications and Limitations of the Multiplier</i>	146
<i>The Multiplier-Accelerator Model</i>	147
<i>How the Multiplier-Accelerator Model Works</i>	149
<i>Conclusion</i>	151
<i>Appendix 7.1: Formalizing the Multiplier-Accelerator Model</i>	152
CHAPTER 8	
Income Distribution: The Utilization-Unemployment Hypothesis	157
<i>Framework and Definitions</i>	157
<i>Determinants of the Labor Share</i>	159
<i>The Wage Lag Hypothesis</i>	160

<i>The Overhead Labor Thesis</i>	161
<i>The Reserve Army Hypothesis</i>	163
<i>The Utilization-Unemployment Hypothesis</i>	165
<i>Present U.S. Income and Wealth Distribution</i>	166
<i>Problems with Measuring Profits, Wages, and Productivity</i>	167
<i>Cyclical Changes in Income Distribution, 1921–1938</i>	169
<i>Long-Run Changes from 1949–1970 to 1970–1982</i>	170
<i>Cyclical Pattern of Labor Income and Labor Share, 1949–1970</i>	171
<i>Wages and Productivity, 1949–1970</i>	172
<i>Labor Income and Labor Share, 1970–1982</i>	174
<i>Wages and Productivity, 1970–1982</i>	177
<i>Unemployment and Capacity Utilization</i>	179
<i>Explanation of Cyclical Movements of Labor Share by Cycle Phase</i>	185
<i>Summary</i>	187
<i>Conclusions</i>	187
<i>Appendix 8.1: Models of the Labor Share</i>	188
CHAPTER 9	
<i>Demand-Side Theories; The Underconsumption Hypothesis</i>	191
<i>Nonsocialist Underconsumptionist Long-Run Stagnation Theories</i>	191
<i>Socialist Underconsumptionist Long-Run Stagnation Theories</i>	193
<i>Criticisms of Underconsumptionist Long-Run Stagnation Theories</i>	194
<i>Marx and Underconsumption</i>	196
<i>Keynes and Underconsumption</i>	197
<i>An Underconsumptionist (or Realization or Demand-Side) Business Cycle Theory</i>	198
<i>Operation of the Underconsumptionist Cycle Model</i>	202
<i>Evaluation of the Underconsumptionist Cycle Theory</i>	204
<i>Appendix 9.1: Formalizing the Underconsumption Cycle Model</i>	205
CHAPTER 10	
<i>Cost of Plant, Equipment, and Raw Materials</i>	208
<i>Theoretical Views of Capital Costs over the Cycle</i>	208
<i>Previous Empirical Studies of Differential Price Changes</i>	208
<i>Cyclical Price Movements, 1949–1970</i>	210
<i>Cyclical Price Movements, 1970–1982</i>	211
<i>Conclusions</i>	213

<i>Appendix 10.1: Formal Econometrics Explaining the Ratio of Raw Materials Prices to Finished Goods Prices</i>	213
---	-----

CHAPTER 11

Overinvestment and Reserve Army Theories of the Business Cycle: A Walk on the Supply Side	215
<i>Marx on Cyclical Behavior of Short-Run Capital Costs</i>	216
<i>Nonmonetary Overinvestment Theory</i>	216
<i>Hayek's Theory of Capital Costs</i>	217
<i>An Overinvestment Model of the Cycle</i>	219
<i>Operation of the Overinvestment Theory</i>	222
<i>Evaluation of the Overinvestment Theory</i>	222
<i>Marx on the Reserve Army of Labor</i>	223
<i>A Reserve Army Theory of Long-Run Stagnation</i>	223
<i>A Reserve Army Cycle Theory</i>	224
<i>A Model of the Reserve Army Theory</i>	225
<i>Operation of the Reserve Army Model</i>	227
<i>Evaluation of the Reserve Army Cycle Theory</i>	228
<i>Appendix 11.1: Formalization of the Overinvestment and Reserve Army Models</i>	229

CHAPTER 12

Profits and Profit Rates	232
<i>Definitions and Biases in Profit Data</i>	233
<i>Long-Run Profit Rate Trends</i>	234
<i>Weisskopf's Analysis of the Rate of Profit</i>	235
<i>Cyclical Behavior of Total Property Income and Corporate Profits, 1949–1970</i>	237
<i>Cyclical Behavior of Corporate Profits and Total Property Income, 1970–1982</i>	238
<i>Other Components of Property Income, 1970–1982</i>	239
<i>Cyclical Behavior of Profit Rates, 1949–1970</i>	241
<i>Cyclical Behavior of Profit Rates, 1970–1982</i>	242
<i>Comparison with Weisskopf's Findings</i>	243
<i>Disagreement with Weisskopf's Theoretical Conclusions</i>	246
<i>Conclusion</i>	247

CHAPTER 13

Profit Squeeze (or Nutcracker) Theory of the Cycle: A Production-Realization Hypothesis	248
<i>Karl Marx and Profit Squeeze (or Nutcracker) Theory</i>	249
<i>John Maynard Keynes and Profit Squeeze (or Nutcracker) Theory</i>	249

<i>Wesley Mitchell and Profit Squeeze (or Nutcracker) Theory</i>	250
<i>Kalecki on Profit Squeeze</i>	250
<i>Weisskopf, Bowles, and Gordon on Profit Squeeze</i>	251
<i>Relationships of the Profit Squeeze (or Nutcracker) Theory</i>	252
<i>Operation of the Profit Squeeze Model</i>	256
<i>Evaluation of the Profit Squeeze (or Nutcracker) Theory</i>	261
<i>Appendix 13.1: A Formal Model of the Profit Squeeze (or Nutcracker) Theory</i>	262
PART THREE: More Realistic Approximations	
CHAPTER 14	
Credit and Financial Crises	269
<i>Common Points in Marx, Keynes, and Mitchell</i>	269
<i>The Marxist Approach to Money and Crisis</i>	270
<i>Early Monetary and Monetary Overinvestment Theories</i>	272
<i>The Monetarist View</i>	273
<i>The Post-Keynesian View</i>	274
<i>Historical Changes in the Finance System</i>	277
<i>Financial International Trends</i>	278
<i>Trends in the Interest Rate</i>	279
<i>The Increase in Cyclical Instability</i>	279
<i>Continuity and Change in Financial Behavior</i>	280
<i>Money Supply and Velocity</i>	281
<i>Total Credit</i>	283
<i>Business Credit</i>	284
<i>Consumer Credit</i>	285
<i>Cyclical Behavior of Interest Rates</i>	287
<i>The Timing of Real and Financial Factors</i>	289
<i>Conclusion: The Cyclical Role of Finance</i>	291
<i>Appendix 14.1: How Does Credit Modify the Profit Squeeze Model?</i>	293
CHAPTER 15	
Monopoly Power and Business Cycles	295
<i>Price Behavior</i>	295
<i>Inflation in Wartime</i>	295
<i>Cyclical Inflation and Deflation before World War II</i>	296
<i>Cyclical Price Behavior since World War II</i>	296
<i>Declining Union Strength</i>	297
<i>The Increase of Monopoly Power</i>	298
<i>Monopoly Power and Administered Prices</i>	301
<i>Explanation of Price-Behavior</i>	305
<i>Monopoly and Profit Rates</i>	307

<i>Monopoly Profit Rates over the Cycle</i>	310
<i>Concentration by Multinational (or Global) Firms</i>	313
<i>Conclusion</i>	314
<i>Appendix 15.1: A Profit Squeeze (Nutcracker) Model with Monopoly Power</i>	315
<i>Bibliographic Essay on Monopoly Power</i>	316
CHAPTER 16	
The International Economy and Business Cycles	317
<i>Rise of the U.S. Empire</i>	317
<i>Decline of the U.S. Empire, mid-1960s to the Present</i>	318
<i>Theory of Business Cycle Spread</i>	321
<i>Investment and Spread of Cycles</i>	322
<i>Behavior of Investment and Trade in the Great Depression</i>	323
<i>Cyclical Pattern of Imports and Exports since World War II</i>	326
<i>International Finance and Transmission of Cycles</i>	329
<i>Previous Empirical Studies of Synchronization of Business Cycles</i>	332
<i>Data on Synchronization of Business Cycles</i>	333
<i>Conclusion</i>	335
<i>Appendix 16.1: Formal Model of International Cycles</i>	338
CHAPTER 17	
Government Fiscal Behavior and the Business Cycle	339
<i>The Endogeneity of Government Behavior</i>	339
<i>The Limited Impact of Fiscal Behavior</i>	341
<i>Long-Run Trends in Fiscal Behavior</i>	342
<i>Cyclical Spending Patterns in War and Peace</i>	346
<i>Total Federal Expenditures</i>	346
<i>Federal Receipts and Deficits</i>	348
<i>State and Local Fiscal Behavior over the Cycle</i>	351
<i>Cyclical Behavior of Total Government Fiscal Activity</i>	352
<i>Conflicting Interpretations of the Fiscal Data</i>	354
<i>Conclusions</i>	357
<i>Appendix 17.1: Government in a Formal Cycle Model</i>	358
PART FOUR: Policy	
CHAPTER 18	
Can Reform Policies Lessen the Business Cycle under Capitalism? Fiscal, Monetary, and Income Policies	363
<i>Some Implications of the Analytic Conclusions</i>	363
<i>Neoclassical-Keynesian Fiscal Policy</i>	363
<i>Administrative Constraints upon Fiscal Policy</i>	364

<i>Political Constraints upon Fiscal Policy</i>	365
<i>Economic Constraints upon Fiscal Policy</i>	369
<i>Monetary Policy</i>	373
<i>Impact of Monetary Policy</i>	377
<i>Limitations of Monetary Policy</i>	378
<i>Monetary Policy, Wages, and Inflation</i>	379
<i>Income Policy: Direct Controls on Wages and Prices</i>	380
<i>A Coherent Liberal Macro Policy</i>	382
<i>Problems with the Liberal Program</i>	384
<i>Suggested Readings</i>	385
CHAPTER 19	
Can the Business Cycle Be Eliminated? Economic Democracy and Democratic Planning	386
<i>Economic Democracy</i>	386
<i>Democratic Planning</i>	387
<i>International Implications</i>	389
<i>Democratic Planning versus Soviet Planning</i>	390
<i>Full Employment: Institutions, Laws, and Performance</i>	391
Appendixes	
A. Definitions of Variables	393
B. Cycle Bases in Seven Cycles	395
C. Cycle Relatives, Average, Seven Cycles, 1949–1982	399
D. Cycle Relatives, Average, Four Cycles, 1949–1970	401
E. Cycle Relatives, Average, Three Cycles, 1970–1982	403
F. Growth per Quarter, Average, Seven Cycles, 1949–1982	407
G. Growth per Quarter, Average, Four Cycles, 1949–1970	410
H. Growth per Quarter, Average, Three Cycles, 1970–1982	413
<i>References</i>	417
<i>Index</i>	433