SOME FEATURES OF POSTWAR BUSINESS CYCLES

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Abstract:
The last century economists have dared to predict, if not the end of the business cycle, at least the progress towards economic stability. This was because of the stabilization policies and structural changes of the postwar economy that seemed to support the reduction of economic fluctuations, at least in the short term. Indeed, postwar expansions have been longer than those before World War I, indicating that recessions have occurred less frequently than in the past. What caused this evolution and what are the characteristics of business cycles since the Second World War are questions that we try to find answers in this paper.

Keywords: business cycle, macroeconomic policies, cyclical synchronization

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INTRODUCTION

Economic reality has seen significant changes after the Second World War and this is visible in every part of it. National incomes, economic growth rates, trade balances, unemployment, inflation, fiscal and monetary policies, the share of industry and services in national economies, foreign dependence, etc. have evolved different. Human existence itself is subject to a permanent social, historical, cultural, political and economic change. Ideas and truths changes, because their fundamentals are others. Instability is the one that always accompanies the search of equilibrium. Commonly, we get used to associate economic instability with cyclical movements, with the succession of expansion and recession periods. There have always been prosperous years and difficult years, because even the sense of prosperity has changed with changing aspirations and human performances.

We used to talk so much about economic development through expansions and recessions that often we do not perceive that our entire existence, not only the economic sphere, evolves cyclical. We talk for example about a daily cycle consisting of hours spent at work and those used to relax. Similarly, we can talk about a weekly cycle; we work five days and dedicate the other two to rest. If these periods of decline of our activities could not be better received, this is not the case when it comes to "rest" the economic activity. Recessions are commonly perceived as an evil that must be removed and not as a period when the economy take a break and prepare itself for another jump. When an economy enters a downward trend, no one could know how many months it will take or how severe the recession will be, how many companies will fail, or how many people will be unemployed. According to Nelson and Kim (1999), business cycle can be regarded as a common cold. Although broadly you know what to expect and what treatment to choose, you never know when you'll get a new cold and how long the convalescence will last. In other words, although the phases of the business cycle repeats, their duration and intensity vary considerably

The period after the Second World War can be characterized in terms of cyclical fluctuations as a more stable one, with a somewhat more gentle evolution compared with previous periods. That's because recessions were generally lower in both duration and amplitude. In this respect, the data provided by National Bureau of Economic Research (NBER), somehow the official forum specialized in economic cycles of the United States, are eloquent. Thus, the average U.S. cyclical contractions decreased from 20.5 months in the prewar period to 10.7 months after the Second World War. Similarly, the average length of expansions has increased from 25.3 months to 49.9 months.

The aim of our approach is thus to identify the main characteristics of business cycles since the Second World War and the extent to which there was a coordinated between them. The main difficulty of this approach lies in the limited data on business cycles outside the United States of America. If we can talk here even about a tradition in dating and explaining cyclical fluctuations, a similar NBER organization in Europe appeared only in 2003, but without to excel in processing and disseminating information on business cycles. On the other regions the data are even poorer. Existing studies are mainly focused on identifying a correlation between regional cycles, synchronization between them and less to make a chronology or to explain what caused these recessions. A more extensive literature is about financial crises, but more often they are presented outside the real economy's cyclical development.

POSTWAR CYCLICAL FLUCTUATIONS

Postwar global economy has seen an upward trend, accentuated especially after the recovery from the oil shocks in the ‘70s. We can even speak of a softening of cyclical fluctuations as economic variables have seen a lower volatility, to which have contributed both fiscal and monetary policies and the improved quality of institutions. Increased stability and durability of expansions seemed to be lasting features of global economy after the Second World War. But this lower volatility does not mean that business cycle has been abolished. The abrupt finish of sustained growth periods of ‘80s and ‘90s provides a lesson about the misfit on time of the policies to prevent emerging risks and new challenges of the economy.

A comparison of the business cycles in the last century indicates an increase in the amplitude of expansions and a reduction of the period spent by the global economy into recessions. In advanced economies, severe recessions almost disappeared after the Second World War. Only the ‘70s have been an exception, the unprecedented increase in oil prices marking a slowdown. (We specify that these features of postwar cyclical fluctuations are not taking into consideration the current global events, their analysis being subject of a future study).

Stabilization of postwar business cycles was attributed to several factors, among which we point higher rates of growth, the lower share of commodity based sectors, the introduction of bank deposit insurance (which has helped to reduce the bank panics) and macroeconomic stabilization policies.

It should be recognized that often some of the factors that determine a recession are considered new at that time. For example, the economic crisis from Asia Pacific was related to external financial vulnerability that has not been identified or properly understood before the crisis. Therefore, maintaining expansions requires the adjustment of macroeconomic policy decisions to commercial and financial globalization process that can generate new risks (see massive investments in American mortgage market).

MACROECONOMIC POLICIES ROLE

According to Christina Romer (1999), the source of continuity and change in economic fluctuations must be sought in macroeconomic policy since the Second World War that has removed much of the shocks responsible in the past for recessions, although it contributed to the introduction of new ones. Macroeconomic variables have become more stable and recessions less severe in the postwar period because both the monetary and fiscal policies have acted as shocks stabilizers. In contrast, the active involvement of governments proved in some cases to be a destabilizing force. We indicate here especially the effects of expansionary policies, to encourage easy access to credits, providing initially an impulse to the economy and placing it on an upward trend. But lacking of correlation between higher investments stimulated by cheap loans and real savings level caused inefficient allocation of resources and precipitated the crisis and the necessary corrections.

Rising prices due to monetary expansion and low demand for investments causes an opposite reaction from monetary authorities and commercial banks that decide to restrict lending and contribute to afferent economic contraction. As stated Rudy Dornbusch (2007), none of the expansions of the last half century in the United States did not die in bed by good death, but were killed by the Federal Reserve System. We underline thus the view that governments have created recessions in order to reduce inflation (Romer, 1999). The fact that the postwar recessions have not been accompanied by deflation supports the idea that they were only to control rising prices, being stopped by government measures before getting worse. But we still retain that recessions corrects just the effects of expansionary monetary policies.

Although monetary expansion has generated rapid economic growth periods, it fueled price increases and boosted investments, often wrongly directed, notwithstanding the real needs of the economy. In essence, business cycles caused by "animal spirits" as Keynes believed were replaced by cycles induced by macroeconomic policies.

We don't have to forget the fiscal policies, which in the good Keynesian tradition were, at their turn, expansionary. Increased investments caused by monetary stimulus have been combined with increased government spending. Stimulating aggregate demand in order to give an ascending trend to the economy has assumed increasing taxes and giving higher privileges to the state. And as we have already seen, state intervention in the economy has not generated each time stability, but often contributed to significant imbalances.

EXCHANGE RATES REGIME

Between cyclical behavior of an economy and its trade regime there is a causal link (Bergman, Bordo, Jonung, 1998). A convertible regime, such as gold standard, is characterized by the existence of some self-regulating market forces that tend to ensure long-term price stability. Thus, changes in gold supply offset inflationary or deflationary price movements. The problem arises when there are shocks on the supply or demand for gold that may substantially affect the price level and real income. Reporting national currency to the price of gold has provided a stable anchor for the international monetary system. In exchange for this stability, however, the economy is exposed to external shocks that can cause imbalances of income and employment. It is also lost the independence of monetary and fiscal policies, because the authorities focus mainly on maintaining the convertibility rather than stabilizing the national economy. Under a flexible regime, monetary authorities may use macroeconomic instruments to avoid shocks, but the lack of a nominal anchor determines the risk of using printing press for the fulfillment of political goals, which inevitably leads to inflation.

Before World War I, when national money supply depended on gold stocks, business cycles were influenced by the discoveries of new gold mines or changes in demand for gold as new states adopt this standard. Another important source of cyclical fluctuations was banking panics, banks portfolios were very less diversified and there was no lender of last resort. However, before 1914 most of the countries was less industrialized, agriculture being the dominant activity. In this context, bad crops were translated into major sources of imbalance. One country shocks were transmitted to other countries that had joined the gold parity through fixed exchange rates. However, the gold standard period was quite stable and experienced significant growth. We can not say the same about the interwar period that meant a mixed regime of floating, managed floating and convertibility. Great Depression, the last century's biggest economic problem, is attributed to pro-gold contractionary policies of the United States, being transmitted globally through gold standard. Recovery occurred only after breaking ties with it (Bergman, Bordo, Jonung, 1998).

The system built at Bretton Woods had combined the flexibility of floating exchange rates supported by the British with nominal stability of gold standard supported by Americans. The system was based on crawling exchange rates; countries could adjust the parity in case of disruptions. The countries had appealed domestic stabilization policies using monetary and fiscal policies. Thus, we go back to the first topic discussed, namely the increased role of macroeconomic policies after the Second World War. Passage to a floating exchange rate regime in the '70s gave greater independence of monetary and fiscal policies. Monetary base had a higher rate of growth, as well as debts reported to Gross Domestic Product. Oil shocks led to recessions that were transmitted between countries despite the specific independence of floating rates. Increased capital mobility interconnected greater the national business cycles.

BUSINESS CYCLES SYNCRONIZATION

Increased global integration of markets for goods and capitals seems to be largely responsible for the increased interdependence of national business cycles. Liberalization of capital movements, floating exchange rates and increased speculative activities have resulted in a closer correlation and synchronization between fluctuations of different economies. Business cycles are considered synchronized if the turning points ('peaks' and 'troughs') occur at approximately the same time. Increasing economic and financial interdependence after the Second World War made global shocks to be transmitted rapidly from one country to another. At the same time, the shocks produced in the United States, as center country, were rapidly transmitted to other countries. Regional economic integration in Europe and North America explains the synchronization of cyclical movements between countries belonging to the same group

Most often, the synchronization of business cycles is attributed to the influence of trade. But theory proved to be not sufficiently clear giving a verdict if the bilateral trade relations result in stronger or weaker synchronization between cycles. On the one hand, domestic shocks are transmitted through trade relations to partner countries and on the other hand, increased trade can lead to higher degrees of specialization, cycles becoming thus asynchronous (Bower, Guillemineau, 2006). However, economic specialization makes countries with similar industrial structures to observe some correlations of their business cycles.

Financial integration is another determinant of synchronizing business cycles. Evidence of financial crisis indicates a direct link between capital flows and business cycles synchronization. Financial ties can bring a greater synchronization between business cycles through domestic demand. For example, if consumers from different countries make significant investments in certain capital markets, their decline could cause a simultaneous decrease in demand for consumption and investment in these countries. Contagion effect transmitted through financial linkages could also result in the spread of economic fluctuations between countries.

International financial linkages could result in specialization of production through the reallocation of capital in a similar manner to comparative advantage in producing different goods. Specialization of production, which may cause a greater exposure to industrial shocks, is generally accompanied by a tendency to diversify the risks through operations on international financial markets.

The problem of synchronizing business cycles seems to be more complicated in the context of globalization. That's because, since the ‘80s, the world economy has seen a rapid increase in trade and financial linkages between countries. Conventional approach suggests that the forces of globalization have contributed to increased economic interdependence between countries and thus to the convergence of business cycles. On the other hand, the good performances of emerging economies, particularly China and India, seem not to be related to slowing growth in most industrialized countries. Such a decoupling of these emerging markets from the industrialized economies is observed (Kose, Otrok, Prasad, 2008), meaning that the cyclical fluctuations from the first are not always linked, synchronized with the cycles of the latter.

CYCLICAL MOVEMENTS VOLATILITY

One important features of the business cycle is volatility. Along with growth rate, volatility determines the length of expansions and recessions. The evolution of income volatility in the postwar period can be analyzed over several periods. In advanced economies, this volatility has been high in the '50s, partly because the Korean War and the rapid reconstruction of Europe and Japan after the Second World War. This volatility has declined in the late '60s, but increased again in ‘70s as a result of oil shocks and “stop-and-go” macroeconomic policies (IMF, 2007). After the deflation of the early 80's, the volatility of the national income of developed countries begins to decline to about a half of that of the '60s.

The same tendency of decreasing volatility takes place in emerging economies, but this occurs later. For example, Latin American countries are experiencing a period of relative stability in the '60s, while China is facing a high volatility. Oil price shocks, increased commodity prices and some effects of contagion from developed countries determined the increase of volatility in these less developed economies, retaining a high level during the '80s and much of the '90s. These periods meant external debt crisis, when were mainly affected countries in Latin America and Africa, banking and financial crises in Asia, Central and Eastern Europe and Latin America. Also, a high volatility faced the states in transition from centralized to market economy. Despite progress towards a relative stability in developing economies, they continue to have a significantly higher volatility of domestic production compared to advanced countries. This is partly due to structural differences, developing countries maintaining agricultural sectors with significant share in total GDP, inefficient institutions and political instability.

Declined volatility after the Second World War is attributed to monetary and financial policies that have created a more stable framework for economic activity, but also on institutions that have worked especially in developed economies. It is not excluded any bit of luck, because external shocks of the postwar period have been limited, if we do not take into account the rising price of oil in '70s.

Relative decreased income volatility is due, to a large extent, to stabilized postwar demand. The accumulation process caused some stability of incomes and thus, of demand. The same effect had certain optimism about the favorable development of economy. Supply, also, has caused fewer fluctuations in the light of the increasing share of services in total output, thus reduced inventory.

Cyclical evolution of the postwar world economy can be characterized by a tendency to increasing global factors influence on the national business cycles. At the same time, for both industrialized and emerging economies, there is a growing importance of group-specific factors. Intensifying trade and financial relations translated into a better cycle convergence within each integrated group. However, domestic factors continue to exert considerable influence on the cyclical fluctuations of a country's economy, increasing trade and financial integration not always resulting into a better synchronization of national cycles.

We cannot speak necessarily about a cyclical wave transmission from developed countries to the periphery, but about their synchronization within either the group of industrialized countries or within the emerging economies group. For example, Asian countries, that used to react immediately to any fluctuation of economic activity in the United States, seems more stable today, partly because they have become more strongly rooted in the Chinese economy, transformed into a counterweight to the United States.

CONCLUSIONS

Despite the forecasts made by Arthur Burns in the '60s, the business cycle is today as alive as then. Even if the postwar period was indeed a time of relative stability, the cyclical fluctuations continue to accompany the course of the global economy, to be part of its resort.

Postwar recessions have seen a decline in terms of amplitude, although there are opinions like that of Christina Romer that puts in doubt that, because of reporting on insufficient data before the war. However, the general opinion seems to lean toward a favorable verdict about postwar stabilization. That's because after the World War II the world economy had impressive growth rates, increased trade and financial transactions, resulting global market integration. This increase is due not only to industrialized countries, largely also contributing to it developing countries, emerging economies, progress and development being the defining characteristic of the period. Volatility of economic aggregates is smaller, allowing stability and growth

Macroeconomic reforms seem to be at least a part of the explanation of this stabilization. And the reforms were made possible because of the institutions that supported them. These reforms, however, have not always worked. It seems that the arsenal to fight recession was not always adapted to the shocks, which most often appeared to surprise the global economy. Oil crises, the debt crisis of Third World, the crisis in Mexico and the one in Asia, not to mention the current crisis, turned into exogenous shocks which led to massive reform efforts towards stabilization and avoidance of new destabilizing factors.

Globalization, beyond the increased phenomenon of markets integration, has resulted in two trends of cyclical fluctuations. On the one hand, being part of a global world means more exposure to fluctuations in other economies, but also can reduce the risks associated with a specialization in domestic production

Beyond the multitude of factors on whose behalf it is put the tendency of reducing postwar cyclical fluctuations, we retain the idea of change: change in policies, structures, institutions, demand, supply, consumer psychology and even the shocks. Of course, the business cycle itself has changed. It has changed, but not disappeared. Beyond the reality of some decades of growth very little deviated from trend, of the satisfied curators who claimed to have found the cure for recession, of the enthusiasm of supporters of a new economy from whose equation business cycle has disappeared, it seems to have revived and "shakes" well global economy. If the recessions of the last half century were mainly specific to each region of the globe, with own intensities and oscillations, we believe we're not wrong to say that the actual world turmoil is an important turning point for a new business cycle, a global one.

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