

## ***Search for a Theory of the Business Cycle***

By FRED HARRISON

Despite their poor track record, economists continue to claim that the harrowing depression of the '30s could not be repeated in the 1980s.

This belief is based on the assumption — explicitly stated in many cases — that we can now track the health of the economy.

Statistical information now enables us to monitor market trends, and to respond quickly as the need arises.

**The flaw in this complacency is that the economists who defend this view — and there are Nobel laureates among them — assume that the theoretical basis of their social science is a match for the challenges that confront the global economy.**

Yet this is precisely where economics, as practised today, is found wanting: there is no satisfactory body of theory to guide effective policy-making, and until we firmly recognise this fact, the prospects of developing alternative hypotheses will remain small.

But what comes first: statistics or theory?

As it happens, the question is irrelevant — because *neither* is a satisfactory starting point for a thoroughgoing overhaul of the discipline of economics.

Let's look at the data first, and pick a problem that ought not to provide room for much doubt: the unemployment figures.

How many people are unemployed? This might not seem too tough a question, because it suggests a simple arithmetic solution: count the people who do not go to work for a living.

In fact, there is considerable doubt about the official figures.

**In Britain**, the official figure last November was 3,094,000.

- Left-wing critics, however, argued that this disguised the true level of unemployment: they wanted to add a further 1.3m, whose plight was disguised by the official exclusion of certain categories of unemployed people, the effect of special employment measures, and so on.
- Right-wing critics, however, maintained that the official figure ought to be reduced by 1.4m, which includes 490,000 people who were allegedly not really looking for jobs.

- The truth is to be found somewhere between the two extremes. Certainly the government's revision of the basis on which it calculated unemployment levels enabled it to argue that there had been an improvement.

*But who can have faith in a flexible truth?*

**In the U.S.**, the improvement in unemployment figures last year worked wonders for President Reagan's re-election prospects.

The drop from a peak 10.8 per cent to September's 9.3 per cent came as a surprise. Was it a reflection of reality?

Well, that depends on which of the two official surveys you believe.

- The Federal government was happy to go along with the household survey, because it showed a sharp fall in the number of people out of work.
- But the payroll survey data implied a September unemployment rate of 10.2 per cent, not the 9.3 per cent that was officially reported to the nation.

As Robert Samuelson noted at the time: "What appears shaky to statisticians, though, is presented to the public as solid. The apparent drop in joblessness has quieted the economic policy debate."<sup>1</sup>

Thus, the forecasts about the direction and pace of growth undertaken by the universities and private institutions is grounded on data that is subject to a rich array of manipulative devices.

This is not calculated to encourage the politicians to change their policies, simply because they cannot have faith in the original diagnosis of the problem.

Mrs. Thatcher's government, for example, fought the general election last June in the belief that the economy was growing at a 3 per cent rate. By November, however, the Whitehall statisticians had re-examined their data, and the figure was reduced from 3.2 per cent to 2.8 per cent.

*Half-a-per cent may not appear much, but it buries a lot of hopes and jobs.*

Are we better off if we turn to theoretical constructs for enlightenment?

Alas, no, as some economists are now beginning to confess.

Herbert Stein, who was chairman of the Council of Economic Advisers under President Nixon, has noted: "We must confess that we don't know what is the optimum path of the economy for price stability and real growth; we don't know how to achieve that path if we could identify it . . . and we don't know what caused the slowdown in economic growth or how to correct it."

The soul-searching is trans-Atlantic. Wynne Godley, the Professor of Applied Economics at Cambridge University, exposed himself to some searching questions from his undergraduates when he declared:

"Macro-economics is in a state of deep confusion. The profession is deeply divided. So far from there being any body of knowledge which is

generally accepted, almost every proposition is extremely contentious. Public discussion of economic policy has no coherent rationale and governments, notwithstanding their emphatic rhetoric, cannot give a credible explanation of how their policies will not achieve the results they seek, nor have they any basis for negotiation with one another."<sup>2</sup>

**Economic theory — as practiced — is no better equipped to head off a re-run of the 1930s than the statistical "evidence" that is bandied about by politicians and the Press.**

That is why a three-year study by the International Federation of Institutes for Advanced Study ought to be fruitful.

Scholars from 15 countries met in Pocantico Hills, New York, last June — and decided to undertake a complete re-examination of their science. The \$1m study is being under-written by the Nobel Foundation in Sweden and by the Rockefeller Foundation in the U.S.

According to Dr. Victor Urquidí, of Mexico, whose report on the global economy served as the starting point for the debate among the economists:

"We are living in a disjointed planet which is based on economic concepts which have nothing to do with present-day reality,"<sup>3</sup>

#### REFERENCES

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2. Wynne Godley, 'Cambridge Keynesianism fights back', *The Financial Times*, 11 May, 1983.
3. Kathleen Teltsch, 'Economic Theories Face Test', *The New York Times*, 21 June, 1983.