CHAPTER TWENTY-TWO

DIRECT POLICIES. II. OTHER FORMS

IN THIS chapter we shall discuss other forms of policy intended to promote the stability of production by acting on production directly. We do not include in this discussion the business-cycle policy of a completely planned economy; the problems raised by a planned economy are entirely different from the business-cycle problems under discussion and cannot conveniently be incorporated in this study. We shall limit ourselves, therefore, to various forms of the partial regulation of production and among those in particular to measures that have been generally advocated, either because they are directed at a strategic variable in business-cycle policy or because they appear to have particularly favorable possibilities of success. Some of the measures to be mentioned have been advocated on both counts.

INVESTMENT CONTROL

A policy advocated in particular from a strategic business-cycle point of view is the control of investment. This policy would be applied particularly in the boom, in order to prevent unjustified expansion of capital with resulting partial overinvestment. It may be applied by such instruments as construction permits, allocation of raw materials, or allocation of capital goods.

If the regulation of investment is successful, it will have a very considerable influence on activity in general; the fluctuations in investment are of sufficient importance, and the fluctuations in consumption are to a sufficient extent derived, to make stabilization of the former an important instrument in the stabilization of the latter. In a country with much international
trade it would be useful to restrict investment in good times as much as possible, in order to free resources for exports, while concentrating investments in depression times. This policy would require priority for investment in the export industries in boom periods.

Restrictions on investment in boom periods may lead to excess liquidity, which in turn may unduly stimulate the prices of shares or lead to an undue expansion of luxury consumption. The policy of investment control should therefore be accompanied either by reduction of this excess purchasing power or by rationing and price control in these other fields.

Investment control may be regulated by various criteria.

a) A rather rough procedure would be to ration, in proportion to the quantities of raw materials or semimanufactured products used in a preceding period.

b) A more refined method would be to allocate on the basis of degree of urgency, which may be judged according to various criteria. With respect to new investment, these criteria might include the expected profits, turnover, or employment; with respect to reinvestment, the age of the capital goods to be replaced, the degree of capacity used of the enterprise, etc.

c) The best criterion would be found by a recalculation, on the basis of certain uniform procedures, of the calculations that guided the individual entrepreneurs in their investment plans; the purpose of this recalculation would be to eliminate all elements of excessively optimistic analysis or prognosis of the business-cycle position. Thus the estimates of prices, costs, and turnover could be reconsidered in a systematic way from a general point of view.

The first criterion introduces a certain amount of rigidity, which is undesirable in general and particularly undesirable in the field of investment; the enterprises or industries that have had large investment activity in a preceding period should not continue to have it in the next period; new industries will require much more investment than old industries, the demand for whose products may be completely satisfied. With respect to the second method, the allocation of a degree of urgency on the basis of divergent criteria implies almost always that the relative
importance of these various criteria has to be reconciled by a rather arbitrary choice of statistical "weights"; the measurement of some of the individual characteristics of a qualitative character is, moreover, in itself sometimes rather arbitrary. In order to eliminate these disadvantages, one should start out from the theoretical point of view that the order of importance of investments should depend on their profitability and that a computation of this profitability should give an unambiguous order of priority. However, the difficulty here is that in practice many of these computations are not very certain, much less certain, in fact, than one might think, and that some account has also to be taken of various imponderable factors. It would seem, therefore, that a certain amount of weighting with somewhat arbitrary weights, as well as the use of somewhat arbitrary numbers for some of the imponderable factors, will always be inevitable. The elimination of excessive cyclical elements by the third method will in any case provide an improvement in the selection of projects.

An important objection raised against investment control is that this form of detailed economic policy will require much time and the submission of a large amount of statistical data by many enterprises. The submission of this material will entail considerable friction with entrepreneurs. The judgment of the various projects will, moreover, require a degree of technical knowledge which is often absent in government offices. For these reasons we do not believe a sudden introduction of investment control to be desirable. Rather, investment control should grow more or less by itself. Industry itself will feel the need for it as it plans with an eye to the somewhat more distant future. Progress in this direction can be made in particular by the organization of various industries, with co-operation on the part of the government that should be to the advantage of both. By this process of co-operation, one can move beyond the stage at which government officials with inadequate technical knowledge either make incorrect decisions or are practically eliminated from the decisions. Gradually, the organizations on the part of industry will appreciate the contribution made by officials who have a more general point of view in economic policy than
does the individual firm or industry; gradually also, the official agencies will become more expert by experience.

It has sometimes been mentioned as an objection against investment control that certain investments for which there is great need in a period of recovery would not be performed. This objection is fictitious, however, and in fact misses the point at issue. The objection is based on the assumption that the business cycle is something objective which has to be followed. But the very purpose of investment control is to influence the business cycle. Experience in World War II indicates clearly that the adaptability of the economy to investment control is much greater than was assumed before.

The weakness of investment control as a measure of business-cycle policy is that it may be effective in limiting investment in the boom but that it can contribute hardly anything to an expansion of activity in the depression. Its significance with respect to the depression is solely that, by correcting overly optimistic profit calculations in the boom, it may reduce disappointment and, hence, undue pessimism in the depression.

CONTROL OF THE PRODUCTION OF RAW MATERIALS

The second form of direct business-cycle policy to be discussed is the regulation of the production of raw materials. The selection of the production of raw materials to be regulated may be justified with two arguments. First, the production of raw materials is often sufficiently concentrated in large enterprises or in a small number of countries to make the regulation of production technically feasible. This applies in particular to the mineral raw materials, which are of the most importance for cyclical movements. Second, the output of finished articles is linked to the quantities of raw materials available, and a regulation of raw materials may therefore lead to some extent to a regulation of total production.

The great difficulty of this policy is to select the proper criterion for the regulation of the output of individual commodities. A complete stabilization of production at a constant level is, of course, never desirable. Nor, however, could one accept a general rate of increase that would be the same for all raw ma-
terials. It is probable that some articles should gradually displace others or, in any case, that the rate of growth for various raw materials should be different. How can one ascertain the proper rate of increase? Clearly not by maintaining constant the individual prices of all raw materials. A stable average price level is desirable, of course, but that does not imply stability of individual prices. The development of the cost of production of one material may be quite different from that of others. If the total demand for goods and services is regulated, the different prices and different rates of output will find their proper level more or less automatically by the reactions of the individual producers; the regulation of each of these individually implies a much greater possibility of mistakes or arbitrary decisions. Even if the total level of output of a given material is determined, there remains the question of the allocation of this total among different producers or different countries. Here again, there is the risk of rigidity, with the corollary of uneconomic production and waste.

Generally speaking, it would not seem impossible to us, with the help of a variety of statistical data, to achieve a reasonable regulation of the production of the various raw materials; but we doubt whether this would mean much as an effective business-cycle policy.

There are other objections to the control of raw materials as a form of business-cycle policy. The value of the output of raw materials is only a relatively small part of total output of all goods and services. The point of application which this policy provides with respect to total production is therefore too limited. There are many ways in which the production of final goods and of services can fluctuate with a constant level of production of raw materials. First, inventories may be used in times of excessive demand and be left to accumulate in periods of depression. Second, the production of articles involving relatively little raw material and much labor can be greatly expanded without any considerable curtailment of production in other directions by the withdrawal of raw materials.

Practical experience with the regulation of the production of raw materials shows, in the first place, that it is technically rea-
reasonably feasible, whenever the number of supplying countries is not very great, such as in the case of tin and rubber, or when production is highly cartelized, such as in the case of iron and steel. The criteria used in the past are, however, on the whole not particularly attractive from a general point of view. Understandably, the objective of regulation was generally the producers' interest, which was often the very opposite of the general interest. The regulation of production in practice amounted to restriction in order to obtain the highest possible price. When restriction was replaced by a policy of expansion of production, after the beginning of recovery or in the light of great wartime demand, producers followed the business cycle rather than attempting to regulate it. They could, admittedly, not have influenced the cycle much since the production under their control represented only a small fraction of the total world production of goods and services. The main importance of past control schemes is, therefore, that they have shown that regulation in this field is technically possible. This may be useful in other circumstances, but the usefulness of these policies should not be overestimated.

COMMERCIAL POLICY

A third method of the partial direct control of production is provided by measures of commercial policy, in particular the regulation by quotas of imports and, in some circumstances, exports. The objective of this measure is usually the regulation of activity in an individual country. The policy may be particularly important for the control of the business cycle if the country under consideration is dependent on raw materials for investment goods, for instance, if it imports its timber, iron ore, or raw iron or steel. The Netherlands is a good example of a country of this structure. By a quota system on the imports of these raw materials, it would be possible to influence investment activity and hence activity in general, to a considerable extent. Many of the objections against the regulation of investment, however, apply also to this form of economic policy; in particular the difficulty of selecting proper criteria. There is the further difficulty that the policy may be partly invalidated by the ex-
pansion of the domestic production of any available raw materials for investment.

Experience shows the technical possibility of applying quota regulations; but it also shows that they have usually been applied with quite other objectives than business-cycle control. Quota regulations initiated in the depression usually turned into measures of protection for the promotion of domestic manufacturing and were applied, therefore, in particular to manufactured products rather than to raw materials.

CONTROL OF THE CONSTRUCTION INDUSTRY

One industry that is particularly suitable for direct control is the construction industry. Technically, control of this industry permits little evasion, as construction activity can easily be observed. Other arguments in favor of control of this industry are that the period of production is relatively long and that the product of this industry has a very long lifetime. These two elements have a great importance with respect to the cycles in residential construction since both of them reinforce the tendency toward fluctuations. An industry that has these tendencies toward a strong endogenous cycle, which tends to influence general activity, should be particularly desirable as an objective of control. Clearly, the price mechanism is not an adequate instrument to regulate the output of the construction industry; this applies in particular to residential construction.

As an instrument one can use construction permits, available in any case, which may be supplemented by a policy of providing systematic information to the building industry, and the resulting control by the industry itself.

The need for dwellings, which can be computed accurately on the basis of the distribution of the population, its income distribution, and its geographic distribution, provides a suitable criterion for the volume of output of this industry. This does not imply that building in each year should be equal to the increase in the need for dwellings. A certain reserve stock may be built up and maintained, which would guarantee that small deficiencies in production would not immediately lead to difficulties.

1. See p. 341, supra.
The production of dwellings may be regulated so as to stabilize either residential construction itself or the general business cycle as much as possible. The second criterion would imply that residential construction would be used partially to compensate fluctuations in other industries by an expansion, for instance, of residential construction in times of depression. We are touching here on the subject dealt with in chapter xxi.

The use of residential construction to stabilize the general business cycle is possible because the need for dwelling changes only gradually and especially because of the long lifetime of buildings; the stock of dwellings is always very large compared to its annual rate of increase, and the latter may therefore be manipulated for business-cycle purposes without any considerable percentage changes in the supply of dwelling services in any one year.

To the extent that an expansion of residential construction in the depression involves certain countries in balance of payments difficulties, a certain adaptation with respect to the raw materials used is often possible; countries short of timber may be able to shift in the direction of stone, brick, cement, and sometimes iron, in order to eliminate excessive use of timber.