Business Cycles

Burns and Mitchell [1, p. 1]:

> Business cycles are a type of fluctuation found in the aggregate economic activity of nations that organize their work mainly in business enterprises. A cycle consists of expansions occurring at about the same time in many economic activities, followed by similarly general recessions, contractions, and revivals which merge into the expansion phase of the next cycle; this sequence of changes is recurrent but not periodic; in duration business cycles vary from more than one year to ten or twelve years.

Aspects of Business Cycles

- Aggregate economic activity
- Expansions and contractions
- Comovement
- Recurrent but not periodic
- Persistence

Temporary Versus Permanent Effects of Recession

In the Solow growth model, the long-run steady state growth path of the economy is independent of the initial state. From this point of view, a recession has no long-run effect on the economy, only a short-run effect.

Endogenous Technical Change

Although the Solow model takes the rate of technical change as exogenous, alternatively one can see it as endogenous.

In a recession, profitability and investment fall, and expenditure on research and development declines. This decline might have a permanent effect on the economy, as future growth sprouts from a lower technical base.

This principle could apply to any historic period. If events had been different a thousand years ago, perhaps the industrial revolution would have started one hundred years earlier, or perhaps one hundred years later.

Severity of the Business Cycle

Has the business cycle become less severe? Are expansions now longer and contractions shorter? Has the percentage reduction of national income and product from peak to trough become less?

The Great Depression

The Great Depression 1929-1940 was by far the most severe contraction in the history of the United States.

In comparison, all post-World War II recessions are mild.

Pre-World War I

The traditional macroeconomic data for pre-World War I show considerable business cycle fluctuation, more than post-World War II.

Romer [2] argues that this difference is just a measurement error. The systematic construction of the national income and product accounts began in the 1930s. Before that time, data are spotty.

Smooth Versus Erratic Time Series

Some economic time series fluctuate sharply with the business cycle, whereas others vary only slightly.

In the post-World War I period, economists focussed on the strongly cyclical data, which show more clearly the business cycle. However these data exaggerate the overall fluctuation of the economy.

References

[1] Arthur Burns and Wesley Mitchell. *Measuring Business Cycles*. National Bureau of Economic Research, New York, 1946.

[2] Christina Romer. Is the stabilization of the postwar economy a figment of the data? *American Economic Review*, 76:314–334, June 1986. HB1E26.