What Business Cycles Cost Us

Part 3

The Answer

\[ \lambda \approx 0.015 \]

Eliminating business cycles is worth as much as a 1.5% increase in consumption.

Since C runs about $7,000 billion per year, this is equal to about $105 billion per year.

A caution: there are some assumptions about volatility, etc.

Moreover

- While Business Cycles have costs, it is also costly to eliminate them.
For some reason, there is an increased demand for Government Spending. The demand curve shifts to the right. This is a business cycle! Obviously there will be some fluctuation in consumption.

Our Options

Accept the cost of this business cycle
Or forego the benefits of the government program.
Our Options

Accept the cost of this business cycle

Warning: there are some business cycles that are clearly wasteful and avoidable. But we don’t want to avoid all business cycles

Our Options

A Second Example

For some reason the demand curve has shifted to the left, and we have a business cycle

Someone proposes to address the business cycle with a bit of pork barrel spending

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While this will eliminate the business cycle, there are real resource costs to this wasteful pork.

A Second Example

Someone proposes to address the business cycle with a bit of pork barrel spending

The Decision

• If business cycles are due to imperfect information, then avoiding them is 100% gain.
  – The Great Depression

The Decision

• If they are due to demand fluctuations or real business cycles, the case is not so obvious.
  – In part the market deals with these fluctuations already.
The 80-20 Rule

• 80% of the damage is due to 20% of the cycles.

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  – The Great Depression
  – The Volker Business Cycle

End

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