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GROWTH, FLUCTUATIONS AND BUILDING POLICY

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The historical series of total production for Western European Countries and for the United States for the last two hundred years reveal two outstanding features. First, there is the unmistakable growth of production, secondly there are the some times very large fluctuations around this growthpath. There has been a very substantial increase in production to benefit everybody, but the rate of increase differed from period to period, and sometimes turned negative. The fluctuations are not always of the same size or length. In fact, by means of statistical analysis economists have been able to single out a number of characteristics of these fluctuations.

Our present condition is not very different, We are still experiencing economic progress over long periods, accompanied by ups and downs over shorter intervals. The fluctuations can be divided into two classes. First, there are those regular fairly periodic short cycles with a length between three and five years, and then there are irregular and not frequently occurring deeper depressions and/or periods of extremely booming growth.

It is important to study the place of the building sector in this pattern, because sometimes it is at the root of these fluctuations, sometimes, it is itself influenced by them, and at still other times activity in the sector will be used to counteract them as part of public policy. The main reason why the building sector is so important in this whole is because the total output of the sector (houses, factories and infrastructure) is tied up with investment. Both economic theory and experience indicate that

unevenness in the rate of capital accumulation or investment is perhaps the main cause of economic fluctuations, and building output is by far the largest single component of total gross investment, amounting to between 25 and 55 % of the total.

My aim is to discuss, however briefly, the place of the building sector in both the regular inventory cycle, and the irregular deep depressions, to enquire into its causes and to speculate about the rôle of government building policy to combat them.

SHORT CYCLES

Most economies seem to be subject to an interminable succession of inventory adjustment cycles, mainly originating in manufacturing industry and leading to regularly recurring open or hidden unemployment, to expansions and contractions. Thus we experience a downturn every three to six years which in the 1800's at its worst would lead to unemployment rates of 8 to 12 %, and which nowadays with all our built-in stabilizers (especially social security and unemployment compensations) at its worst in Western Europe lead to occasional unemployment rates of 4 % to 6 %. Apart from 1967 we have e.g. in Belgium hardly known serious unemployment of even that size in the sixties. Most of the time the economy has been up to such a level of full-employment as differences in regional and industrial development would warrant. The same pattern has also been experienced in most other Western European countries.

In Western Europe as well as in the U.S.A. the stabilisation of total employment at a high level, the balancing of foreign payments and the containment of price rises are the established aims of government policy in the short run. Of course, already in the Middle Ages princes and magistrates alike were concerned with exactly the same problems, and they had ways of coping with them. With

the advent of Keynesian thinking in economic theory, in the wake of the great depression of the thirties, the ways and means of action have become much more formalised and even at times institutionalised. According to present doctrine good government requires excess spending above budgetary receipts when there is unemployment, and the reverse when there is excess demand for labour. Often the idea is to do a major part of excess spending in the construction industry. Thus, nowadays, and certainly in Belgium and to a different extent in other European countries and the USA spending on housing and on public projects will be used to contain the short term inventory adjustment cycle. So far as my knowledge goes this policy started on a systematic basis after World War II. Since then something odd has been happening.

Indeed, from the historic record for the USA and for Britain we know that short run cycles in the economy as a rule were not accompanied by short run building cycles. That is not so surprising since developments in construction activity were (and are) because of the essence of the output involved governed by quite long run considerations, to which regular fairly predictable small changes made very little difference. Thus, one knew long building cycles, but not short ones. Pronounced short cycles in construction, accompanying the general cycle are in evidence, as e.g. in Belgium, in the period after World War II, Despite the professed aim of government building policy that fluctuations in building activity were necessary to counter the general fluctuations, a strong coincidence of both emerged. In the end government policy strengthened rather than weakened the short run cycle. People in the construction industry were being asked to accept quite unpleasant changes in production and employment in order to stabilise the other sectors of the economy temporarily, and then it turned out afterwards that time and again all of them were more destabilised than might have been without the well intended gesture. Something must have gone awfully wrong.

In our book "Dynamics of the Building Sector" we showed that this unintended sorry result came about because of a serious misunderstanding about the nature of planning and production lags in the different subsectors of the industry. We also figures out that, at least in an open economy (but which economy apart from the USA, the URSS and China can still be considered closed?) the instrument of building policy is not so powerful as is sometimes suggested by calculations based on input-output studies. The latter tend to point at very high multiplier effects, whereas we find much lower ones indeed. The explanation for this difference is that the input-output multipliers are static and measure the end effect which may be spread out over a very long period of time, whereas we measure the effect in a period of one year which we consider as more relevant in cycles of short duration.

I want to put forward the hypothesis that for the containment of short cycles of the inventory variety in an open economy it should be avoided to conduct a specific building policy of any great size. To conduct a properly working short term policy requires an amount of foresight on the development of business conditions some two years ahead, which is simply not available in a small open economy. I think that a short term building policy calls for an unhuman, and measured by the size of the likely effect, unnecessary amount of sacrifices on the part of both employees in the sector. I also think that it seriously impairs economic progress and technical innovation in the sector. Since obviously day to day decisions in public housing projects and in public works must be made, I think they should be guided quite shortsightedly by considerations of employment in the sector itself rather than by macro economic aims.

LONG CYCLES AND BUILDING

I am saying that a building policy aimed at combating short periodic cycles is bound to do more harm than good. I am not saying that we can do without a building policy with macro economic aims. But that policy should be aimed at the long run. Obviously, it would be nonsense to pretend that there should be no government building policy at all. In many countries the state is the largest single customer of the industry either for public works, or for state manufacturing or service enterprises or for home building, and sometimes in more than one field. The total amount of investment involved is necessarily very large and very relevant to employment of production factors in the industry, and to the total level of production to be attained by the economy at large. There is need of foresight and planning, that much is clear.

In the postwar period we have not known major depressions. Many economists believe that they are a thing of the past and gave up thinking about the root causes of them, under the mistaken assumption that it can't happen again to us. Economists thought that in 1928 as well. Serious depressions occur not frequently, and when they do it tends each time to be for quite different reasons. I think it still could happen to us nowadays, yet I hope that the mere fact that I will enumerate some alternative causes will not be held against me as a doomsday forecast.

One basic cause for a spectacular decline in economic activity may be military war. A prolonged war in the Middle East for example could seriously affect supplies of crude oil and the effect on the level of European production could be quite substantial for quite a while. Another factor may reside in the conditions of international trade and payments. Violent changes in long established exchange rates may lead to a very different optimal distribution of production locations over the world. It

may suffice that one single government of a large country chooses the road of protection for the others to follow suit. The harm that could be done to world trade is evident, and would be a major calamity for exporting economies. Shall governments be able to hold the rate of inflation under control? It implies in the end that they follow a much less expansionary monetary policy. Yet, when inflationary expectations have got hold of everybody that may be very hard to do. Friedman and Schwarz presented convincing evidence that this monetary action was at the root of the great depression in the thirties. Are we better equipped to deal with the situation today?

We know from the historical record that the building industry has much to fear from the sort of developments mentioned. A strong and lasting decline in general production leads after a while inevitably to a more than proportional decline of the demand for all sorts of construction. The revenue of the state itself tends to dwindle and funds for relief projects, which are then very much called for are hard to come by, because of the inevitable mistrust about increasing the public debt when it is hard to see when the loans will be paid back. Moreover, in the present setup more than in the past the welfare commitments will be quite a burden under adverse circumstances of the sort mentioned.

The foregoing suggests that the basic conditions affecting aggregate production are very relevant to the activity level in the building industry. On the other hand there are autonomous factors that may affect the building industry and that can contribute to the creation of long cycles. In the history of the USA, of Britain and of Germany e.g. cycles in building activity of long duration have been observed which, because of the multiplier action, have forced the level of national production upwards for long stretches of time, and strongly downward afterwards. As it

happened there were often 20 years intervals between the big surges, although few people believe that that is more than a coincidence. Two basic motives for the long building expansions and contractions are developments in transportation and its connected infrastructure, and autonomous movements of population either through growth or immigration. I will limit attention to the first, although the latter may be quite important in countries where there are numerous immigrant workers.

The evidence on the link between the introduction of new transportation methods and total building activity is very clear and impressive. Important were in the USA the emergence of canals in the 1830's, a first outburst of railroad construction in the 1850's, a second outburst in the 1860's and a third in the 1880's, the introduction of street and electric railways around 1910, the first automobile explosion in the 1920's and the second after World War II. Similar developments occurred in Europe around slightly different times. These outbursts each time meant long prosperous periods for the construction industry, since always total building demand exceeded the yearly building capacity by very much so that years of full-time work at high wages and profits were secured. The essential point is however, that the very large direct requirements for transport infrastructure, were to be surpassed very often by the even larger indirect ones stemming from the concomitant relocation of industry and the connected relocation of housing that accompanied each innovation in transportation.

What condition are we in today? Obviously this will vary as between countries. As regards Belgium one may wonder e.g. to what extent the road infrastructure expansion is a thing of the past and whether with an almost constant population, the demand for housing can reasonably be estimated at more than 50.000 units. Certainly it is more important to build things that are vitally needed than merely to build! It might be more important to rebuild our cities thoroughly than to build more expressways, more important to make the existing city dwellings inhabitable than to construct isolated houses for everybody on the countryside.

CONCLUSION

In this talk I wanted to discuss two basic points as regards building sector policy, the first being concerned with short run policy and the second with long run considerations. I argued that one should not employ building sector policies to combat short-run cycles. On the other hand I believe that one should develop a coherent policy as regards long run changes, both in transportation technology and in urban requirements, as well as regards the other macro-economic eventualities that may affect aggregate demand in a country and therefore the building sector.

Is this not being done? Are not the planning bureaus drawing up plans of our future? Of course they are. But I wonder whether it is being done in the right spirit, and whether the correct questions are being pursued. Most of the plans that I could lay eyes on are merely extrapolations of past figures, without much connection with developments of the real needs. The point is that the building sector is at the basis of the vital infrastructure of the country, and that it is impossible to conceive an autonomous long run building policy if one has not taken basic options as regards urban and suburban design, industrial location and transport developments. Solutions to these problems are necessary for the sustained long run growth of the construction industry, and it is important both for the sector and for a country at large that new creative ideas are pursued in this field.

The long run policy problem towards the building sector is a very challenging one indeed. A solution requires vision as regards the alternatives, and courage when it comes to making the great choices. I do not doubt that the workers of the industry will rise to the challenge.

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