THE TRADE CYCLE

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THE TRADE CYCLE

AN ESSAY

BY

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TO

MY MOTHER

PREFACE

A NEW theory of the Trade Cycle! I offer this, well knowing that whoever ventures to add to the multifarious literature on this subject must incur the reader's extreme displeasure, if he fails to show that he has something of importance to add. This essay only presents the outline of a theory; and properly, because the facts on which it is based may be summed up in a few broad generalizations about which there is common agreement; to construct a more highly elaborated theory would probably involve going further than these warrant.

There are three main sources from which the ideas that are developed in this volume are derived. (i) There is a well-established relation, vouched for by experience and the laws of arithmetic, between the demand for consumable goods and the demand for durable goods, the essence of which is that the absolute amount of the latter depends primarily on the rate of increase of the former. The implications of this for trade cycle theory are here explored. (ii) Mr. Keynes, in his recent volume, *The General Theory of Employment, Interest, and Prices*, has developed certain important ideas concerning the relations between the demand for capital goods, the propensity of the community to save, and its general level of activity and income. Full use is made of these. (iii) I have had occasion in the past to work upon the theory of imperfect competition; the object of this branch of economics has been to bring the general theory of value into closer relation with the facts. The doctrines so developed have proved of relevance to the trade cycle problem.

Although the main ideas upon which it is based are drawn from three separate sources, the theory here presented is itself single and indivisible. I should claim on its behalf that a larger number of the special phenomena of the trade cycle are accounted for as the necessary consequences of its central propositions than are accounted for by any other theory.

There is another aspect of this essay to which I wish to draw attention. Much has been heard recently of the desirability of making economic theory more 'dynamic'. A successful attempt to do this should involve the formulation of a new set of propositions, relating to the increase of wealth and income, having the same cogency and demonstrated by the same kind of methods as those of static theory. In fact, writers seeking to introduce dynamic considerations have often tended to confine themselves to mere description or to develop a theory regarding time-lags. But is not a theory of time-lags or of friction premature when the fundamental propositions relating to velocity and acceleration remain unformulated?

The characteristic method of static analysis is to suppose that in certain circumstances a certain set of prices is established. Next it is considered whether individuals, having the tastes and needs that they have in those circumstances, can improve their position by altering their line of conduct. If they cannot, the prices are said to be in equilibrium, and it is assumed that they will remain unchanged until some change in the circumstances occurs. By this method of reasoning a set of most instructive propositions, sometimes known as the laws of supply and demand, has been established. The weak point in the static theory is that, in order not to be too remote from the facts, it is often assumed that one line of action, which individuals take, is to save so and so much. An attempt is made to demonstrate what determines the equilibrium price for this saving, viz. the rate of interest. Yet really the supposition of saving is inconsistent with the pre-requisites of a static analysis, for, if any net saving is occurring, the quantity of capital and the income-earning capacity of the community must be growing, and the factor of growth does not appear among the static assumptions.

An attempt has been made in this essay to adopt a procedure in relation to the factor of growth similar to that of static analysis, to seek, namely, for the moving equilibrium of a steady rate of growth, by asking what sort of action we must suppose individuals to take in certain circumstances, so that, having regard to the circumstances and the factor of growth which their action entails, they will not be able to improve their position otherwise than by continuing to act as they do. The consequences of this attempt are embodied in my theory of the 'dynamic determinants'.

The procedure is, so far as I know, a new one. If it be judged to have had even a partial success in this analysis, the way appears to be open for a great and important extension of economic theory along these lines.

My chief debt of gratitude is to Mr. J. M. Keynes, whose brilliant lucidity, great constructive power, and fine discernment of what factors are likely to be important have done so much to advance understanding in this field. Readers well acquainted with his writings will find traces of his influence at many points in this essay, besides those at which specific reference to him is made.

I am also grateful to Prof. D. H. Macgregor for his encouragement and for a number of valuable suggestions. Mr. J. E. Meade and Mr. W. M. Allen have read through these pages, and their acute comments have enabled me to make various improvements. To Mr. H. D. Henderson I am indebted for giving me a lucid and helpful explanation of his difficulties. The proof sheets have been inspected by the vigilant eye of Mr. R. H. Dundas. To all of these I extend my thanks.

CONTENTS

INDEX

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