Those Vicious Business Cycles: Tamed But Not Quite Slain
By RICHARD W. STEVENSON (NYT)

WASHINGTON -- The stock market was booming. Companies were fighting their way into fast-growing foreign markets. Technology was transforming many industries.

A blue-chip panel of business leaders, economists and government officials hailed "the dynamic equilibrium of recent years," and the "organic balance of economic forces." Their report on the nation's economic outlook concluded: "Our situation is fortunate, our momentum remarkable."

The time was mid-1929.

Economists have never displayed much skill in predicting recessions. But one thing is common, historians have found, to most periods just before a downturn -- the emergence of a widespread belief that this time we have found the magic elixir to produce an extended period of prosperity.

So it may be tempting fate now that so many economists, policy makers and business executives, looking out over an economic landscape defined by years of moderate growth and low inflation, are willing to judge the business cycle tempered if not tamed. But for all the risk of incurring the wrath of the economic gods -- and with the important caveat that recessions can never be completely ruled out -- it is clear that the economy has undergone such sweeping changes that it is arguably better equipped to maintain its long-run equilibrium.

"I have felt for a long time that the business cycle was diminishing in its severity, but it has not by any means been vanquished," Geoffrey H. Moore, the director of the Economic Cycle Research Institute in New York, said.

"The length of expansions has tended to increase, and we're certainly having another exhibition of that in this case," he said. "The severity of the contractions or recessions that happen during the next phase of the cycle has been diminishing."

The National Association of Business Economists recently surveyed its members, and found few who see anything but sustainable growth and low inflation ahead.

"While all business cycles eventually end, almost all of the 44 economists who responded to the survey expect economic expansion to continue for the foreseeable future," the association said. "That conclusion may not be precisely what Ludwig van Beethoven had in mind in his cantata 'Calm Sea and Prosperous Voyage,' but the approximation appears to be close."

In March, the current expansion will be six years old. It is the third-longest recovery on record, and if a recession does not strike in the next three years, it would become the longest peacetime expansion, overtaking the 92-month recovery in the 1980's.

Just after the turn of the century, growth continuing apace, the expansion would break the 106-month record set in the 1960's when the Vietnam War gave the economy a boost. And if that is still a bit far off to contemplate seriously, there is still little to suggest that the economy will deviate any time soon from its path of moderate growth and low inflation.

The Federal Reserve seems to have hit on just the right monetary policy formula, with unemployment low but wage and price increases showing no acceleration. Congress and the Clinton Administration are pledging fiscal responsibility.

By continuing to invest in new equipment and squeezing more efficiencies from their work forces, companies have managed to maintain profit growth. Despite a veiled warning about the dangers of a speculative bubble from Alan Greenspan, the Federal Reserve chairman, the stock market has so far held on to nearly all of its huge gains the last few years. And there is an increasing consensus that faulty statistics have led us to
overstate inflation and understate improvements in growth, productivity and other indicators of economic well-being.

Still, to the extent that bumps along the economic road have been smoothed over, stability has come at a substantial cost. Improvements in productivity in recent years have come in part from wide-scale layoffs, creating a new level of anxiety in the work force. And among business and political leaders, there are those who argue that stability has been bought at the price of forgone growth and opportunity.

"We're taking a low-risk approach to policy," said Tracy O'Rourke, chairman of Varian Associates, a health care and semiconductor equipment company in Palo Alto, Calif. "I can increase my production significantly faster than I can sell units."

Moreover, a more moderate business cycle does not necessarily foster progress in dealing with other deep-rooted problems, like income inequality. Most emphatically, it does not mean that individual companies or entire industries will escape upheaval.

Indeed, some of the same forces that are dampening the economy's ups and downs, most notably the globalization of competition, are speeding the life cycles of products and technology in other industries.

That puts more pressure on companies and their employees and creates an environment in which political pressure to "do something," such as erecting trade barriers or providing a special tax break, erupts regularly.

Still, to the degree that it averted painful downturns and created an environment in which businesses could make plans with some degree of certainty about future conditions, a long-term moderation of the business cycle would be one of the great economic achievements of this half century.

Of course, the economy's true resilience will only be determined as it is tested by imbalances of one kind or another. But a recent study by the National Association of Manufacturers, a leading proponent of the idea that the economy can grow faster, sought to calculate what would happen if any one of several big problems afflicted the economy in coming years. In no case did the group's study show the economy going into recession, or anywhere near it.

If consumer spending fell by $40 billion over six months, or less than 2 percent, the growth rate of the overall economy next year would be trimmed to 2 percent from the association's current projection of 2.4 percent, the group said. If Congress and the Clinton Administration failed to agree next year on a plan to balance the budget and long-term interest rates rose by half a percentage point as a result, the economy would grow about half a point more slowly than expected.

Similarly, the group found that a half-point increase in inflation would knock less than half a point off the growth rate. Even a rise in oil prices, which have been highly volatile in the last year, would barely budge the economy. The manufacturers association said that a $5-a-barrel increase in oil prices would cut growth by half a point.

Economists generally agree that expansions do not simply die of old age. They end because of a policy mistake -- allowing inflation to get out of hand or stepping too hard on inflation and extinguishing growth -- or because of an external shock -- a surge in oil prices or a war -- that is too powerful for even good policy to contain.

The chances of being thrown off track by an external shock are by definition unknowable, and in that sense, a downturn is always a possibility. On the other hand, the Federal Reserve has brought the nation closer to price stability than would have been imaginable 20 years ago. And the Federal Government, after a spasm of fiscal irresponsibility 15 years ago, is no longer debating whether austerity is necessary and achievable, but how much the nation should sacrifice to achieve it. As a result, the likelihood of a whopping policy blunder seems relatively low.
Moreover, many economists said, policy stability is only the beginning. "Are we guaranteed that forever and in all ways the Fed will continue to get it right in the future?" asked Mark Dadd, the president of the National Association of Business Economists and the chief economist at AT&T. "Certainly not. But there is reason to believe that there are other things going on that could reduce the severity of any downturn."

On the most sweeping level, inflation is arguably less of a threat than it has been in decades. The reasons go beyond just tight monetary and fiscal policy. Some economists -- and many business executives -- contend that ever-increasing global competition and the changing nature of the relationship between employer and worker has constrained if not broken the old pattern of wage-price spirals.

Executives in many industries report being caught in a pricing stasis. They cannot raise prices for their products, so they refuse to pay higher prices for raw materials and supplies.

"We've been resisting any price increases from our suppliers because it's very difficult for us to pass those along to our customers," said Ronald D. Bullock, the chief executive of the Bison Gear and Engineering Company, a maker of electric gear motors in St. Charles, Ill.

At the same time, the declining power of unions, the willingness of workers to accept pay raises at or below the inflation rate, slower growth in health insurance costs, layoffs and the fear of them and new wrinkles in employment, such as using contract workers, have conspired to keep compensation costs down.

On a more mundane but no less important level, companies have achieved better control of a nuts-and-bolts business issue -- managing inventories -- that has always played a critical role in the economy's stability, or lack thereof.

In the past, the economy often tipped into recession when companies had built up inventories of products or supplies when demand had slowed, forcing them to cut back production or new orders, thereby reinforcing the slowing or the contraction of the economy.

But now, all along the supply chain, companies are ordering only as much as they can use or sell immediately. In the personal computer industry, for example, companies like Dell and Compaq manufacture a machine only when they have an order in hand, and they buy components accordingly. Taking advantage of technology to give them up-to-date information about stock levels and consumer demand, retailers are keeping minimal inventory on their shelves and in warehouses, and are demanding quick turnaround times from suppliers when they do make an order.

"Our customers are not placing orders with us except on an immediate-ship basis," said Warren Batts, chairman of Premark International, which makes small appliances. "They're not overstocking at all, not taking any chances of overstocking. This is new." For all the positive structural changes, however, economists warned that the economy's apparent equilibrium should not be taken for granted.

"There is nothing structural that eliminates the possibility of business accumulating inventories too rapidly, then having to disgorge them," Richard D. Rippe, chief economist at Prudential Securities, said. More broadly, he said, there is no assurance that wage increases and commodity prices will remain level and that financial markets will continue their upward march.

"The picture right now looks very good," Mr. Rippe said, "but the notion that it couldn't turn for the worse is too optimistic a view."