Recession in the United States

by

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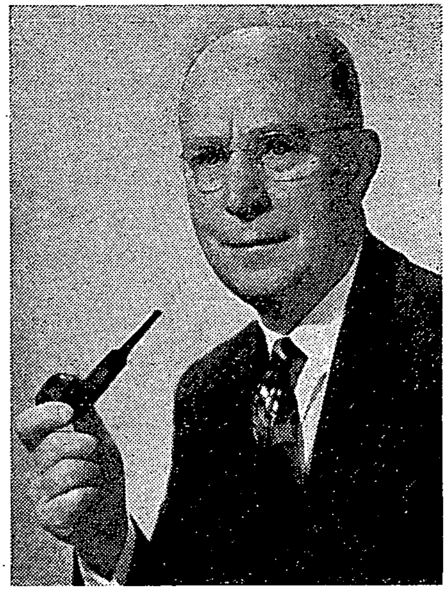

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Professor Condliffe is an Australian-born economist. Later he lived in New Zealand where as an officer of the Statistician-General's office he made the first cost-of-living study in the Dominion.

He has had an outstanding career in economics holding several important professional posts at prominent Universities.

In 1931 he joined the secretariat of the League of Nations and was the author of the famous Annual World Economic Survey published by the League. Professor Condliffe is the author of several books. For his last book, "The Commerce of Nations", he was awarded the Wendell L. Willkie Prize for the most valuable work published on an international subject in 1950.

In this article he deals with a subject of great current importance and incidentally makes some penetrating comments which should contribute to our understanding of the American giant.

ECONOMIC policy all over the world is affected by the view taken of imminent developments in the United States. Whether one likes it or not, the United States is a tremendous force—by the volume of its imports and the demand for its exports, by expectations of financial aid in one form or another and by mingled hopes and fears of private investment by American firms. Its highly developed national economy is something of a colossus. Without its productivity, reconstruction after the second world war must have been a more chequered and painful, as well as a longer, process. There can be few responsible people in the free world who do not feel a sense of gratitude for the writing off of Lend-Lease obligations and for the subsequent succession of aid programmes by which the United States has contributed generously to reconstruction in many countries. There has always been some apprehension mixed in with this gratitude. One school of economists was apparently convinced that a severe financial crisis was bound to supervene when war orders ceased—something like 1920-21, if not 1929-33. This did not happen. It is in fact a remarkable achievement that has kept the United States economy expanding, with only minor hesitations and adjustments, for eight years following a great war. During these eight years there have been first the conversion from the war to peace, with a considerable, perhaps too great, measure of disarmament, and then a partial reconversion to armament production, now beginning to taper off. Mistakes of economic policy have been made, more perhaps in the rearmament than in the disarmament period; but on the whole the American economy has taken these changes in its stride. The most noticeable setback to expansion, in 1949, did not amount to more than a drop of approximately 3% in the national income.

IT is true that even such a small setback was exceedingly troublesome to other countries. In part this is a reflection of the weight of the United States in the world economy. In language that Australians can appreciate, an English economist expressed this to me by remarking that "it's bloody uncomfortable to be in bed with a giant." But in larger part, the extraordinary importance attached to an adjustment which was not at all severe in the United States measures the extent to which other countries, willingly or not, had become dependent on the United States maintaining its expansion. In some, reconstruction after the war, coupled with maintenance of expanded social security and generally higher living standards at least for the mass of the people, had entailed a volume of imports which constantly pressed upon their diminished reserves of foreign exchange. In others, ambitious developmental projects produced the same result. In some, there was, for political or social reasons, a long-continued reluctance to face the economic facts of life and set about the painful tasks of reconstruction with diligence and fortitude. As long as inflationary policies, for whatever reasons, continued to be the rule, the margins of foreign exchange available were inadequate to meet even minor strains such as those caused by a small dip in American prosperity and buying power.

It must be said that the national income is not the best measure of what happened in the United States in 1949. The index of industrial activity fell not by 3%, but by 8%. Imports fell by 7%, but imports from the United Kingdom fell by 21%. These are annual figures measured from 1948 to 1949. If the measurements are made from the peak of activity in the last quarter of 1948 to the trough in July, 1949, the figures would be more dramatic.

This could happen again. Indeed it is quite likely to happen before many months pass by. There is widespread expectation, reflected in the stock exchange, though not very perceptibly as yet in any but odd sensitive indices of economic production and trade, that the spring of 1954 may see something of a recession in the United States. The order of magnitude that is envisaged is more like 8-10% than 3%, which would mean a correspondingly greater fall in industrial activity and imports. Up till now (September, 1953), production and trade continue to expand and there are optimists who point to reassuring facts such as the very large volume of personal savings in the hands of consumers and the large volume also of planned industrial investment for expansion. A substantial proportion of the saving, however, such as contributions to pension funds and life insurance, cannot be regarded as liquid, and the expectations of entrepreneurs can change suddenly.

THESE expectations are the key to the riddle. It is the private, not the public, sector of the national economy which is most liable to expansion and contraction in a cyclical fashion, if indeed much faith can any longer be placed in such an unpredictable concept as the business cycle has proved to be. There is some reason to think that the current talk of imminent recession is widespread enough to have set in motion the changes in expectations that will bring about a recession. It is of course possible that they have also set going preparations to forestall the worst effects of such a recession. But clearly the most important factor is the old and tried, but so recently despised instrument, of monetary policy. Even before the Republican administration came into office, the Federal Reserve Board had successfully freed itself from Treasury domination to the point where it could set about regaining the control of the money market. As long as it was committed to maintaining gilt-edged securities at par, the commercial banks, which had large holdings of these securities, could always put themselves in funds by selling them to the Federal Reserve Banks. When the Board allowed these securities to fall below par, it put itself in a position where it could exercise pressure on commercial banks by the traditional methods of raising the discount rate, increasing the percentage of reserves the banks were required to keep and, if necessary, selling securities at the market price. The inevitable result of even mild steps in these directions was to cramp the lending policies of the banks and tighten credit. It now costs more to build a house or expand an inventory.

Informed economic opinion applauded these developments which follow the same pattern as the steps by which the Bank of England has secured control again of the London Money Market and proceeded gradually to free it from the maze of regulations under which it had laboured so long. It is surely unreasonable to argue that what is good policy in London is reprehensible in Washington. The real issue is how far and how fast a tightening of credit should go. The monetary network is something like the nervous system. The immediate effect of a stimulant or a depressant must always be considered with one eye on the longer-run effects which are not immediately visible. I am often reminded of these almost-subterranean effects when my neighbour up the hill, who belongs to the soak school of gardeners, leaves his lawn-sprinkler on too long. After a brief interval soggy patches begin to appear in my garden down the hill and these continue to expand for some time after the sprinkler is turned off. In much the same way, when the Federal Reserve Board tightens credit there are some secondary consequences which after an interval create soggy patches in the national economy at points rather remote from those immediately affected by the credit stringency, and these are apt to continue to get soggier for some time after the Board has stopped its disciplinary programme. One such soft spot at the moment is farm prices. Another may turn out to be instalment buying for example of automobiles—the banks are pretty well loaned up now on such paper.

Still others may be the construction industry and inventory accumulations at various stages in merchandising from manufacturer to retailer. It is a tricky calculation to determine just when deflationary pressures have gone far enough but not too far. And the reversal processes do not operate instantaneously. The deflation continues to percolate underground for some time.

It is these monetary decisions, affecting the expectations of the private sector, rather than economies in public spending, either for foreign aid or for domestic armament programmes which now seem likely to bring about some recession in the American economy. The pressure on interest rates and credit availability, however, is not likely to go much further. The Treasury has a rather large part of the short-term debt to renew, and if possible to fund, in the next few months. But the steps already taken have not yet exhausted their deflationary effects throughout the national economy.

THERE is a case for arguing that the only country in the world which ought to err on the inflationary rather than the deflationary side is the United States. It is the area where the slogan of full employment ought to be taken most seriously. Only thus can other countries, such as those in the sterling area, contribute to the restoration of international economic equlibrium and at the same time build up their exchange reserves. Larger reserves are needed to tide over precisely such temporary strains on balances of payments as are likely to be caused by a recession in the United States. It is unfortunate that these reserves have not been built up more in these past eight years. But it is asking a great deal of a country organised as is the United States, always to conduct its domestic policies in such a way as to spare other countries the necessity of providing adequate reserves against such emergencies.

It is the path of wisdom to expect and prepare for periodic strains of this character. This is what foreign exchange reserves are designed to do. It may well be that the best way to provide adequate reserves would be to strengthen (and activate) the International Monetary Fund. But the difficulties which the raw-material and food-exporting countries in particular face in accumulating adequate reserves can hardly serve to justify expectations that the United States will so conduct its economy as never to make use of such reserves necessary. It is true that fluctuations in the terms of trade are the most bothersome of all the factors which affect the sterling area's balance of payments. When raw-material prices are high the manufacturers of Great Britain face high import costs and therefore higher export prices (as do those in other manufacturing-export countries, including the United States). When they are low, the raw-material exporting countries have fewer dollars. But the terms of trade are not determined solely by the great manufacturing countries. The relative movements of import and export prices (which constitute the terms of trade) depend upon developments both of supply and demand. The proximate cause of their fluctuations may be the expansion or contraction of manufacturing activity; but these are not the sole cause.

Of one fact there seems to be reasonable certainty. There is little likelihood that any recession will be allowed to develop into the destructive downward spiral of a major depression. Already the President's Council of Economic Advisers is preparing a shelf of public-works projects. Taxes are bound to come down. There are other compensatory devices available, including a loosening of credit by the Federal Reserve Board. All these take time to bring into operation and more time to become fully effective. The exact moment when they should be launched is not easy to determine. A threatened recession may develop some momentum before the brakes begin to work; but no democratic government can afford to risk delaying their application to the point where bankruptcies and unemployment become self-perpetuating. There is a congressional election every even year in the United States, including 1954. In too many countries economic policy is still directed towards warding off the depression of the nineteen-thirties. Risks are not run and hampering regulations are not removed because of this deep-seated bogey. Eight years after the war, with at least two minor recessions overcome and a third expected recession likely to be limited in time and scope, it is time that this bogey was laid to rest. Apart altogether from action which even a conservative administration must take if it is to retain popular support, the resilience of the American economy should be sufficient guarantee. After twenty years of income redistribution and government experiment, it is not what it was before 1932. *There are tremendous forces of expansion at work which will shake off deflationary influences long before they reach depression proportions.*

IF there were space, one could tell the same sort of story in regard to another bogey. *The United States is moving towards freer trade in the long run; but in the short run there are temporary setbacks.* This kind of thing must be expected in the attempt to apply direct representative democracy to a community as large as the United States. Its economy is not a monolithic structure directed towards a single defined purpose by a centralized dictatorship. It is the confused result of a diversity of purposes sought by dispersed interest over a wide area. Nothing of this sort has been known before on this scale. Peoples of diverse ancestry, scattered over a continent of equally diversified resources—dry-farmers in desert areas, cattlemen and sheepmen on wide expanses of sparsely-grassed mountain ranges, high farmers in the deep soil of the river valleys, cotton-growers on small share-cropping lots or on great mechanized farms as in Texas and California, speciality croppers and growers of staples, to say nothing of the workers in enormous factory areas in country towns as well as seaboard cities. To mobilize a public opinion that ranges from sophisticated New Yorkers to the back country dirt-farmers of Louisiana, from the open spaces of Texas to the stockyards at Chicago, is not a simple process. Government proceeds by compromise. *By and large the United States moves steadily towards taking up the responsibilities commensurate with its economic strength. It does so by the democratic process which is often disappointing but is the ultimate source of its strength.* Sometimes its behaviour may seem erratic. There are impatient idealists who would put it in the straight-jacket of some form of leadership. But it does best for the world as it is, an ebullient, vital, sometimes unpredictable, expression of the faith in which it was founded, the equal right of every common man to have his say. *This gives scope to all sorts of crankiness, but it also liberates from the masses of the people an enormous and vital energy without which the world would be poorer.*