# If There Were An American Recession![*]

WHAT would be the effect on the sterling area countries, and more particularly on Australia, of an economic slump in the United States?

The asking of this question does not imply a prediction. On a matter upon which such wide differences of view exist among authorities in the United States itself, the I.P.A. would be foolish to express an opinion which, from this distance, could at best be only partly informed. There is already a mild business downturn. Unemployment has increased over recent months to a figure of around 3,700,000 or 6% of total employment; industrial production has also fallen slightly. It is impossible to say how far this downturn will go. It may not go very far. On the other hand it could conceivably develop into a real economic recession. This possibility is being so extensively canvassed throughout the world that some discussion—broad though it must be—of the impact of an American recession on the sterling area and on the Australian economy should be of interest, and may be of some educational value.

In the event of an American recession, would the Australian economy be seriously affected, and, if so, how?

We should be clear in our minds about the word "recession." The distinction which the economist draws between "recession" and "depression" is not mere professional affectation, a distinction made with the perverse intention of confusing the uninitiated. It is of very real scientific importance and practical utility and must be understood before any intelligent discussion of the subject is possible.

"Depression" means economic collapse—large-scale unemployment, widespread business losses and bankruptcies, unsaleable surpluses, idle plants, a general loss of confidence in the future. This was what happened in the Great Depression of 1929-33. But few people imagine that a recurrence of these conditions in the America of today is at all likely.

* Some will already claim that there is a recession in the U.S.A. In the precise meaning of the word "recession" that is true. However, we prefer to reserve the term "recession" for a decline in economic activity of reasonably substantial proportions—say where unemployment is of the order of 8% to 10%. It is in that sense that the term is used in this article.

If depression, then, can be taken to mean a critical economic illness, recession is no more than a temporary indisposition. It can be as mild and as short-lived as a bilious attack or as uncomfortable and prolonged as a persistent winter cold. It is a recession that is feared in America today. *Hardly anyone expects the abundantly robust economy of the United States to become, all of a sudden, dangerously ill.* Those who have been predicting a recession in the U.S. almost invariably mean a more or less moderate decline from a level of economic activity which, for the past two or three years, has been approaching boom proportions. There would be some unemployment, although in total it should stop far short of being disastrous; some businesses and some industries would experience difficulties; adjustments would be necessary in various parts of the economy; but in general business would continue to be reasonably active. On the whole, the United States, judged by pre-war standards, would continue to enjoy a state of more than ordinary prosperity.

CLEARLY, then, a recession, if it comes, should not be a very serious thing for the American people—although it could have grave political implications for the administration at Washington. But, if past experience is any guide, what might be quite a small set-back in the United States could have far-reaching effects on the rest of the world and particularly on the sterling area countries.

In 1938 the gross national product of the United States fell by 4%. But this comparatively small drop resulted in a very large reduction in American demand for the products of other countries. The total value of American imports fell by 36%, imports from Britain fell by 41%, and purchases from the overseas sterling area by 50%. Even the "pause" in American expansion in 1949 (it was not much more than that, as production merely steadied and there was even a slight increase in personal consumption) had a startling effect on American demand for sterling area products. Imports from the United Kingdom dropped by over 20% and from the overseas sterling countries by 15%. Admittedly the recession of 1938 and the pause of 1949 were of comparatively brief duration, but it does not necessarily follow that a rapid recovery can always be expected. *As a matter of interest, during the Great Depression of* 1929-33, *imports from the United Kingdom were cut by* 77% *and from the overseas sterling area by* 81%; in other words the dollar market for the sterling area nearly vanished altogether.

THE evidence of the past then all strongly suggests that the sterling countries are dangerously sensitive to any decline in the level of American economic activity.

It seems certain, then, that the sterling area would not remain unaffected by a recession in the United States. It would be affected in two main ways:

First, the dollar earnings of the sterling countries would fall, and if the recession were deep or prolonged, the fall could be considerable. Under these conditions, and in the absence of special measures of financial assistance, countries such as Britain and Australia would have no alternative but to intensify their already severe restrictions on dollar imports. The scarcity of dollar goods would become more pronounced and economic development in Australia and other countries would be slowed down. The slow march toward the goal of sterling convertibility would be put into reverse, and if the American recession were a large one sterling could be confronted with its gravest dollar crisis since World War II.

Secondly, the decline in business in America would be transmitted to other countries. Recession in America would slow down the tempo of world economic activity. On some countries, such as Malaya, whose economy is highly dependent on the American market, the effect could be particularly serious. In other countries, such as the United Kingdom, where dollar exports are a relatively small part of total export trade, the direct effects would be more difficult to assess. The loss of dollar earnings and the consequent restrictions on imports of dollar goods could give rise to shortages of raw materials and to localised unemployment in industries depending on those materials.

*But the U.K. would probably be most seriously affected by the loss of income in those countries with whom she trades and on whom she depends for vital exports.* These losses of income would arise from the effects of a fall in American demand on the volume of trade and world prices of basic commodities and manufactured goods. World demand and prices over a wide range of internationally traded goods would certainly decline.

The U.S.A. is the major customer for many of the world's raw materials. She consumes 62% of the world's rubber, 20% of the wool, 30% of the cotton, 52% of the tin, 53% of the zinc and 56% of the manganese.

To take an example close to home, let us assume that, as a consequence of American recession, there was a material decline in wool prices. As easily the most important influence on Australia's external trade this would lead to a substantial reduction in Australia's overseas income. Faced with an adverse balance of payments, Australia would be forced to cut its spending abroad. This would react seriously on Australian demand for British exports and for the exports of other countries which have to be paid for in sterling. The American recession would thus be transmitted to Britain by an indirect route, even on the assumption there was no large reduction in the American market for British manufactured goods—which, almost certainly, there would be.

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WHAT of Australia? The loss of export income would tend to set in motion the classical pattern of business recession in Australia. Internal spending would be cut back, overseas reserves would fall, the banking position would become tighter, business would take a more cautious view of its programmes of capital development. If the loss of export income were of large proportions, some unemployment would probably be unavoidable. Undoubtedly modern anti-recession measures in the monetary, fiscal and public works fields would be put in train and it would be hoped that these steps would moderate the secondary consequences of the loss of export income. But the effectiveness of such measures would certainly be reduced by the high level of internal costs, which, in an environment of falling world prices, might prove to be seriously uneconomic.

It is, perhaps, not well known that of all basic commodities wool has been the most sensitive to changes in business conditions in the United States. This is shown in a massive study of sterling area trade carried out by the Economic Co-operation Administration in 1951. After one year of recession in the three periods from 1929 to 1930, 1937 to 1938, and 1948 to 1949, the average decline in the value of American imports of wool from the overseas sterling area was 54%. This was a greater fall than that shown by any other basic material. Imports of rubber declined by 44%, tin by 26%, jute by 27%, cocoa by 50%. The average for all commodities was 34%. After three years of depression during the Great Depression the value of American imports of wool had dropped by 91%. The sensitivity of wool to American recession is partly explained by the fact that a large proportion of the wool consumed in the United States is produced domestically, and in conditions of declining business the home-grown product tends to displace imported wool. Since wool is a commodity marked by extremely inelastic conditions of supply, the surplus that cannot be placed on the American market is diverted to other markets with a depressing influence on prices. In the 1929 Depression wool prices fell by about 60% and in the recession of 1938 by about 37%.

There are some reasons for thinking that an American recession at present might have a much smaller effect than past recessions on American demand for main sterling area commodities such as wool, rubber and tin. This is possible. Over the last eighteen months American imports of wool have been much below previous levels, despite the existence of near-boom conditions, and prices for sterling commodities, such as rubber and tin, are already very low. For instance, U.S. imports of sterling wool in 1953 were only 50% of those in 1952 and 75% of the boom year 1951. It has been suggested that American imports in quantity would be unlikely to fall much further even in the event of recession.

There is one force on the debit side whose strength cannot be mathematically computed or even vaguely estimated—that is, the psychological effect on the rest of the world of a recession in the United States. If the predominant and by far the most robust economy in the world began to suffer from a mild economic indisposition, other much weaker and more dependent countries would begin to fear that they might soon have to take to their beds. The mental climate would not be conducive to the enterprise and boldness upon which the continuance of a high level of activity depends.

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*In conclusion, it needs to be re-emphasised that this article makes no forecast of what will happen in the United States. There has already been a slight contraction of business activity although this is yet some way from being sufficiently great to be called a recession.* From this distance it is impossible to say whether this mild downward movement will shortly halt* or whether it will continue and business conditions grow worse. One factor should not be overlooked. *Both in economic understanding and in international sentiment the America of today is very different from isolationist pre-war America. There is a real awareness in top government and business circles of American responsibilities for under-writing economic stability in the rest of the free world.*

***In this regard a view expressed as late as March 16th by Dr. Arthur F. Burns, Chairman of the Presidents' Council of Economic Advisers is of interest.**

"Let me say, first of all, that economic activity, taken in the aggregate, has declined since last July, and that unemployment has developed in different localities. The nation, taken as a whole, nevertheless continues to enjoy a high degree of prosperity. The dollar value of the output of all goods and services is only 3% less than in the all-time record quarter of 1953.

"The decline of personal incomes has been even smaller. Th[illegible]volume of purchasing by consumers and by government is close to recent [illegible] levels. So, too, are the expenditures of business firms for new plant, m[illegible]ery, and equipment. Businessmen, however, are no longer spending substan[illegible] sums on adding to their inventories, as they did six or nine months ear[illegible] Indeed, business sales are not outrunning production. In the process, in[illegible]ories are being brought into better alignment with current sales and a fou[illegible]dation is being laid for a new economic advance.

"Stock prices, which reflect the prevailing state of business sentiment, are appreciably higher today than last July, when business was at its peak. Commodity prices, on the average, have remained virtually unchanged since then. The privately held money supply is larger. Business failures have declined in the last two or three months; while contracts for construction, which have been consistently high, have recently risen further.

"In view of these and related developments it seems reasonable to expect that our economy will weather its present difficulties successfully and that the economic advance of our nation will soon be resumed."