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The Challenges to President Ford

by Professor Robert G. Wertheimer, Cambridge/Mass. *

According to the author the US economy is not in such a bad condition as usually depicted, but the relapse into a severe recession and uncertainty after thirty years of uninterrupted upward movements has been shocking. President Ford, although facing a self-assertive Congress, with his gradual and imperturbable response seems to apply the right medicine for mastering the present unfavourable situation.

The Nixon inheritance presented the new President with political and economic challenges of unprecedented magnitude. In this atmosphere, the mere fact of being a President spells a dilemma. On the surface, nothing good seemed to shape up on the horizon. The complete withdrawal from a hated war is followed by the threat of a domino sequence. The need of forceful executive leadership at home and abroad to reassure friends, deter foes, cooperate with but not submit to Congress is being frustrated, while economic challenges are reminiscent of the Great Depression. The fuel crisis and costs, the need for unexpectedly large budget deficits, the public distrust of big business and disillusionment with government as well as the lack of restraint of the media in the national interest would impose enough burden on any unimpeded executive.

A Self-assertive Congress

President Ford, of course, is facing a more self-conscious Congress determined to reassert itself — by action or inaction — after the drought period under President Nixon. As hard choices still have to be made which will burden the consumer still further and not restore quickly a better living standard, both the Executive and Congress are manoeuvring in such a way as to have the other blamed by the public for whatever unpopular measures have to be taken. What the President by upbringing and ingrained concepts least wanted to do, he has to do: to run a peace-time deficit exceeding any precedent; adding to the price of fuel to force down consumption; reduce real spending on armament; start public works programs for the unemployed instead of pushing the private economy into job creation. In search for a consensus of the national purpose and national will, the President is reading the signals correctly,

even though his responses have been applied only hesitantly so far. Unemployment has moved into the most prominent place of the national concern, even outrunning inflation. It is being better understood by legislators and the public that major changes are under way that will have to be dealt with, in particular the economy will need far larger amounts of personal and business saving for investment, otherwise a sufficient rate of economic growth cannot be achieved that is needed to reduce unemployment.

The President's Time-table

In the American system of checks and balances, the current composition of the Congress and the role of the Executive after the Nixon era has encouraged more checks than balances. The Congress is in an assertive even though not very creative mood, while the President does not hesitate to use his veto weapon amply. Internationally, with a freer hand, he is looking ahead actively; he has closed the books on Vietnam and he will not open new ones in Southeast Asia, though he has never changed his views that *pacta servanda sunt*. While it should not affect President Ford's domestic policies, he certainly will make his bid for the Presidency in 1976. This datum, no doubt, is providing him with a time-table of the degrees of urgency to cope best with the domestic problems of recovery, unemployment and inflation in this order, and to make sure that the international perimeter is at least kept stable, even if no conspicuous successes can be scored at the moment. That means no Mid-East War, a continued move toward détente with the Soviet Union, friendly relations with the Common Market and Japan and a rescue-standby posture if things in England should deteriorate beyond expectations. In this spirit, the interpretation of the new Trade Act of 1974 will be exercised, the participation in the

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meetings of the International Monetary Fund proceed, and Secretary Kissinger's slide-board exercises with the Mid-East and the Soviet Union continue.

Concerning the economy, the President holds the view that with the tax cut and easier money policies (a promise extracted from Chairman Burns by the Senate Finance Committee), all is set out right: the inherent forces of the economy are taking over, the crisis will subside and the boat of the economy glide safely into port. If one searches for a special sense of direction, no major additional economic initiatives beyond the tax cuts are under way, as most economic policies undertaken so far are considered on target except on energy, still under dispute. The end of the recession is assumed to be at hand and thus the rudder is being held in order not to stir up inflation again¹. Actually, the Economic Policy Board now stresses *inter alia* international economic problems such as dealing with energy, the world monetary structure and commodity price demands of third nations. In some detail, the scenario unfolds as follows.

The Patient

Actually, the American economy is not in such bad condition as usually depicted, but the relapse into a severe recession and uncertainty after thirty years of uninterrupted upward movements has been shocking. True, the output of goods and services even at the 1975 lows, exceeds more than four times amounts produced in 1940. True, Americans still have living standards that by far exceed the status of their older brothers or parents of the fifties and sixties, but the very fact of the dramatic decline in jobs and extreme inflation has deeply depressed consumer sentiments and their willingness to borrow and spend amply. Thus it is ironic that these sounder ways of the consumer now — getting less into debt, saving more, buying less cars and fewer houses — are at the root of the economic slump we are now experiencing but they are not being praised as a "return to the Puritanical way", or as the realization that only a slower economic growth can be lasting.

Focussing on the economic lows to be reached by the end of the second quarter of 1975, the US economy is working 20 p.c. below potential capacity and industrial output has declined 15 p.c. from its high in mid-1974. Inventory swings from an expansion of a \$ 30 bn annual rate to a liquidation of \$ 3 bn, making for a gap of \$ 33 bn, easily explain the expected slow resumption of industrial pro-

duction. After the high levels of profits in 1974 blown up by inflated inventory gains, 1975 will see a decline by 20 p.c. but not below typical profit ranges of other good years. Wage and unit labor costs — due to continued low productivity resulting from capacity under-utilization — have been moving upward at annual rates of 12 p.c. causing great concern of a new inflationary momentum in later years.

As a knight in shining armor the Congress moved against the economic decline with a small lance hesitantly accepted by the Administration which had other plans providing a total of tax reductions of \$ 20 bn for 1975; the actual bigger deficit of \$ 45 bn expected for fiscal 1975 will have been chiefly the result of declining tax revenues due to the weaker economy, but not being caused by dashing new spending plans or dramatically large tax reductions. The public at large, indeed, is receiving a tax refund of \$ 8 bn spread over May and June. Various other stimuli such as a 10 p.c. investment tax credit for business (instead of the current 7 p.c.), a 5 p.c. tax credit up to \$ 2,000 for the purchase of a new home, extended unemployment compensation up to 65 weeks, etc., provide other stimuli but by no means a cornucopia. More significant for the economy will be the expected budget deficit of \$ 70 bn for fiscal 1976 with Federal spending projected at \$ 367 bn and revenues of under \$ 300 bn reflecting the limited tax raising capacities of the still weak economy. So far, it is expected that the old nostrums will do their job — expansionist monetary policies and Federal deficits, the public being only in some doubt as to the correct timing and the necessary magnitude of both measures.

The Monetary and Financial Sector

According to the monetarists, it was Chairman Burns and his followers in the Federal Reserve who brought on the inflation/depression in the first place, first by permitting excessive monetary expansion in 1972-3 (M-1 growth at 9 p.c. per annum), leading to excessive inflation to be followed by a credit crunch in the spring of 1974 (at an M-1 expansion of 3 p.c. and less). The Chairman has already started to make the Federal a more suitable instrument of recovery setting the M-1 expansion at the range from 5 to 7.5 p.c. per annum to be timed with the economic turnaround and developments of the money markets. His policies in any case will have to accommodate the financing of the Federal deficits projected at \$ 45 bn for 1975 and \$ 65 bn for 1976. While labor leader Meany is pleading for immediate deficit spending of \$ 100 bn, Secretary Simon of the Treasury is basically unhappy with any deficit, though he accepts the projected ones as being

¹ Incidentally, this comes close to the views of OECD in its May 21 statement "that enough action has already been taken to stimulate economies and that too much stimulation would lead to opposite results".

in line with our financial abilities, nor is he too concerned about the crowding out potential of private capital needs by this Government financing. The compatibility between private and public borrowing needs also is reflected in the continued easing of the commercial prime rate from the high of 12 p.c. in 1974 to a current 7 p.c. and probably a still somewhat lower level in the near future.

The Inflation / Unemployment Sector

In recent years, inflation trends were chiefly related to labor power when wage increases exceeded gains in productivity. Other factors also added to inflation, such as rising cost of Government and deficits, the emphasis on services little lending themselves to productivity gains and market power practices of business and labor. And finally, the unique 1973-4 experience: the effects of the dollar devaluation, shortages of industrial capacities, the food and enormous oil price inflation and the oil boycott, to name only the major factors in this dismal cycle of economic excesses. Institutionally wrong monetary policies were other factors in the price spiral. While inflation is declining sharply now with the principal stimuli not continuing their sharp upward move such as prices of food and fuel, there is growing concern that inflation again may become rampant in two years, once economic growth has been restored to 4 p.c. annually or better. Careful monetary and fiscal policies and better labor-management relations are considered indispensable to achieve a better price balance also supported by a major effort of Government restraint in spending and taxing.

Concerning unemployment, the figures in the spring of 1975 are dismal: close to 9 mn unemployed and 4 mn on part time. In August, 1974 unemployment was at 5 p.c. and employment at a high of 87 mn. Then the dam broke: payroll employment in particular declined from 78 mn to 75.5 mn in April, 1975, though it should be emphasized that even this reduced figure is far above the 1970 level of 71 mn employed wage earners. Unemployment increased by three to five hundred thousand each month late in 1974 into early 1975. However, it must not be overlooked that sometimes 2.5 mn new job-seekers enter the labor market in a single year. The market has a tremendous potential, too, in adding jobs, having provided 3 mn additional jobs from September 1972 to 1973 and another 1.4 mn from September, 1973 to the high of August, 1974. Women and teenagers are forming now a much bigger share of the labor market and unemployment than in the past, and while structurally heads of households still have the least unemployment at 5 p.c.

and white collar workers at the same rate, this gives little comfort considering blue collar worker unemployment at 11 p.c., teenagers at 20 p.c. (whites) and up to 40 p.c. for non-whites. In overall unemployment, non-whites have the higher rates of 14 p.c. against whites of 8 p.c., due to the greater prevalence among the former of less skilled workers and less seniority. The rapid decline in employment in the car industry and in housing together perhaps represent one-half of the increase of unemployment recently. Employment has started to rise again, but the absorption of the already unemployed to which those still entering the labor market should be added is expected to be a very slow process, even if the economy should regain a 4 p.c. annual growth rate soon. Of course, an unexpected resumption of this rate to 6 or 7 p.c. maintained into 1977 could bring down unemployment to the 5.5 to 6 p.c. range (every 3 p.c. economic growth being the equivalent of 1 p.c. decline in unemployment). Obviously, even in the most optimistic labor market boom, all 9 mn reported as unemployed would not be employable. In fact, even if one-half of this number — that is, 4.5 mn — could be placed in positions, we would not reach the stage of full employment (now defined as 95 p.c. of the labor force).

The Outlook

Time is moving fast and the Presidential election of 1976 will be soon upon us. The incumbent President and his Vice-President Rockefeller will form an unbeatable team, provided that the economy will have improved significantly and remain promising by mid-1976 and later. That is, an economic growth rate of 4 to 5 p.c. annually will then have to be operating, retail sales and business investment spending will have to be strong, the Federal deficit under better control, the dollar stabilized internationally and inflation still abating — that is, not exceeding 5 p.c. Naturally, money and credit must not be tight and the prime rate stabilized at 6–7 p.c. In unemployment, any trend downward will count and its reduction to 7.0 p.c. or 7.5 p.c. as the low in August 1976 as well as expected substantial gains in employment will make Government claims to successful anti-unemployment measures creditable. Of course, a larger military hardware program badly needed also would create jobs faster and so would a much larger public works program than presently contemplated. Perhaps the adoption of such measures may be reserved by the President for the final economic push in 1976. An over-heated, inflated expansion into 1977 would give recession signals for later and advise Chairman Burns to move more capably than in the past between the Scylla of a credit squeeze and its consequences and the

Charybdis of too rapid money growth. However, while the wisdom of a Till Eulenspiegel laughing while climbing a mountain and serious while coming down from one is laudable, we should not kill an incipient boom because we might be afraid that it could lead to a more severe recession subsequently.

Obviously, international factors — chiefly political — may have a bearing on the recovery, but it is unlikely that they may turn it into unfavorable directions, unless the accessibility of Mideast oil

again becomes impeded. Certainly, the simultaneous overcoming of the unfavorable business cycle in OECD countries will assist in the American advance, which at the same time, however, is becoming the main hope for a world-wide trade recovery. While President Ford did inherit the American economy in a tailspin, his gradual and imperturbable response seems to be the right medicine presently to move out of it, well-timed with the Bicentennial of America, the beacon of the Free World.

The Decline and Fall of US Foreign Aid

by Professor George J. Viksnins, Washington *

Foreign aid, once hailed as "the most unsordid act in history", is in deep trouble. Despite the exhortations of the Pearson Report¹, the call for sweeping reform by various governmental commissions and the annual plea to Congress of the Agency for International Development (AID), economic assistance is rapidly declining, and the future looks even bleaker.

Western opinion concerning the development process generally has come full circle. The 1950s, and even the early 1960s, can be characterized by the optimism contained in W. W. Rostow's well-known book on economic growth, modestly sub-titled "A Non-Communist Manifesto".² All countries are treated alike by Rostow; rather precise dates are assigned to the "take-off", and Rostow's extrapolation places India and Indonesia a few steps below Mexico and Malaysia on the magic escalator of growth. Just as the 1950s were naively optimistic on the subject of economic development, the 1970s seem destined to become the decade of pessimism, and the 1980s appear to be scheduled to fulfil forecasts of doom. Food shortages and higher oil prices, uncontrolled inflation and the dollar's fall from grace, and increasing disparities between the rich and the poor all seem to validate the dire predictions of the Club of Rome's *Limits to*

*Growth*³, just as Rostow's *Stages* was the book of the late 1950s, so *Limits* seems to epitomize the pessimism of the 1970s.

Aid a Futile Exercise?

Many Americans, as well as Europeans no doubt, have come to regard foreign aid as a futile exercise, if they think about it at all. Critics from both sides of the political spectrum have continued their attacks. The conservatives have argued against it all along — "Keep money at home", "relief of the poor defeats its own purpose", "aid destroys initiative and breeds government planning and socialism", and so on.⁴ More recently, the liberals and the centrist majority have become disenchanted as well. Aid is viewed as a "Cold War relic", "an instrument of American imperialism", and as a method for dumping surplus US goods (and services) on insulated markets. Foreign aid and investment are synonymous with neo-colonialism and exploitation; "revisionists" and

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¹ Lester B. Pearson, *Partners in Development*, Praeger Publishers, New York 1969. This report was commissioned by the World Bank, and recommended a 1 p.c. of GNP aid target to the industrialized countries, to be reached in 1975.

² W. W. Rostow, *The Stages of Economic Growth*, Cambridge University Press, Cambridge 1960. Interestingly, a second edition was published in 1971 — attempting to defend the basic approach.

³ Cf. D. H. Meadows et al, *The Limits to Growth*, Universe Books, New York 1972. See also Dennis L. Meadows and Donella H. Meadows (eds.), *Toward Global Equilibrium*, Wright-Allen Press, Inc., Cambridge, Mass. 1973.

⁴ For an able presentation of some conservative criticisms, see P. T. Bauer, *Dissent on Development*, Weidenfeld and Nicolson, London 1971.