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Has the Recession been Overcome?

Interview with Professor Dr Hans-Jürgen Schmahl, Head of the Division of General Economic and Trade Cycle Policies of the HWWA-Institut für Wirtschaftsforschung-Hamburg.

IE: Professor Schmahl, the belief in the manageability of cyclical trends held in the sixties has taken a knock. Last year the industrialized countries of the West experienced their deepest recession since the war, with the number of unemployed going up to 15 millions. What are the causes of this downslide?

SCHMAHL: I think that this world-wide recession could be most appropriately described as "stabilization crisis", for the crucial factor were in my opinion the unprecedentedly severe and unmitigated restrictionist policies which almost all countries pursued in 1973/74. These policies either accentuated or triggered the well-recognized causative mechanism of a cyclical downturn — especially the inventory and investment cycles. Some countries were hit when persistent pressure on profits had already rendered the propensity to invest more susceptible to reverses. The cardinal question however is of course why so many countries engaged in such unusually massive policies of restriction. The answer is that they had to because of increasingly onerous inflation and balance of payments problems. The oil price explosion was the last straw; by aggravating the infla-

tion as well as the balance of payments deficits in many countries, it left them no choice but to put an end to their gross neglect of the stability objective. The oil crisis however has in my view merely precipitated what was in any case an inescapable stabilization crisis. This crisis was bound to happen.

IE: Has the downslide now come to an end? What has 1976 in store for us?

SCHMAHL: It appears from the most significant indicators — and one must not of course go by the customary comparison with the preceding year which reflects the historic rather than the current trend — that as a result of the change in economic policy from a restrictive to an expansionary course most industrialized countries reached rock bottom some time in 1975. Important exceptions are Italy and Great Britain; in these countries it is at least uncertain whether the downtrend has come to an end. In the USA and Japan the upswing is already under way; in the Federal Republic of Germany and France there are signs that it is beginning. In 1976 we shall see the real gross national product increase in most countries. For all the OECD countries together

the rise may work out at about 5 p.c., in 1975 their real GNP went down by 2.5 p.c.

IE: What chances do you see for a substantial reduction of unemployment in the year ahead?

SCHMAHL: In the initial phase of a cyclical recovery the rise in production is always seen to be attended by only a small increase in employment. At such times productivity is said to be rising particularly fast. The true explanation is that during the preceding recession phase employment did not fall off as much as would have corresponded to the requirements of production. There are many reasons for this — impediments of labour legislation, trade union pressure and management policy due to charitable motives or to economic considerations such as the high cost of training new personnel when demand increases once more. An additional factor in the last recession was that short-time working was often subsidized by the state. At the end of this recession the number of the "workless on the job" is especially large, which means that the number of the "officially" unemployed cannot be reduced a great deal in 1976; in some countries it will not be brought down at all.

IE: In the USA the upswing set in a little earlier than in other countries. The rise in production there however went hand in hand with escalating inflation. How great a risk is there that the new economic cycle may turn into another inflationary cycle and we shall be forced to resort to a new stop-go policy?

SCHMAHL: No definite judgement can yet be passed on the price trend in the USA but the signs are not propitious. There is indeed a danger that a new upsurge may reinforce almost everywhere the inclination to put up prices. The wages would in that case probably not be slow in following. Most countries are far from having broken with the anticipation of further inflation; they had to abandon their restrictive economic policies for reasons of employment policy when there were still quite strong inflationary tendencies. The possibility of resort to a stop-go policy cannot therefore be ruled out anywhere. It can only be avoided if the struggle for the distribution of the fruits of production does not again become as fierce as it has been. Under a stop-go policy the chances of a substantial reduction of unemployment would be minimal.

IE: The Federal Republic of Germany has had to wait for the cyclical turn-round longer than others. Why was this so?

SCHMAHL: It was connected with the concurrence of two circumstances: During the downswing the Federal Republic was to the fore, and its dependence on external economic developments is much greater than that of the USA or Japan for instance. Despite its own efforts to stimulate economic activity it therefore failed to achieve a cyclical turn-round while the demand from its major trading partners was still strongly recessive. It was not without cause that the

cyclical turn-round in the Federal Republic coincided with a turn-about in the curve of orders received from abroad. Only after this turnabout was the effect of domestic stimuli no longer weakened by negative influences from abroad. In my view the effect of the investment premium on order stocks in industry would have been significantly smaller had there not been a turn-round in the demand from abroad.

IE: International trade, especially the foreign trade of the developing countries, was of course hit by the world recession. How will it develop in future?

SCHMAHL: In 1975 the world trade contracted more sharply than world production. That was no doubt a consequence of the heavy inventory reductions. The exports from developing countries (non-oil countries) for the same reason suffered a more than proportionate decline during the trade recession. The reversion of the cyclical trend in the world is now likewise opening more than proportionate opportunities for them. In 1976 the world trade will certainly expand more than world production, for the replenishing of the inventories of raw materials and other primary products no less than of other goods will be one of the principal factors making for expansion. The industrialized countries will offer much larger outlets to the raw material exporting developing countries. Adjusted for price changes, the world trade volume may be expected to expand by 6–7 p.c., that means about as much as it contracted in 1975.

IE: Which factors could prevent or hamper a world-wide upswing?

SCHMAHL: Although a world-wide upswing in 1976 may be considered as certain, the durability of this trend is still being

questioned. One of the reasons for such doubts is the general feeling of uncertainty generated by the unusually sharp reverse in 1974/75, by the experience of the oil crisis and, above all, by the phenomenon of "structural change" which is being talked about by people everywhere even though they have only vague ideas about it. I think that the real importance of the structural change as an impediment to a new upswing in the world economy is widely overrated. One should not talk as if there had never been a structural change before. I am inclined to think that all this will lose much of its negative psychological impact when people notice that things are really moving up — which many have not yet done. A real danger to the new upswing could possibly arise if the inflation gathers fresh momentum. If that were to happen, there would be a threat of stagflation or stop-go policy or both.

IE: Normally one ought to learn from experience. What lessons do you think should be learnt from the recent developments?

SCHMAHL: The most important lesson to be learnt seems to me to be this: The presumption that high employment could be achieved, not only in the short term but permanently, by countenancing inflation was illusory. Inflation as a habit threatens to incapacitate any Keynesian employment policy; in the end it would only lead to stagflation. To put it differently: Inflationary habits decisively lessen the manageability of economic trends. The medium-term prospects for the economy and for society alike cannot be very good if those concerned — central banks and governments, employers and trade unions, and the various kinds of pressure groups — will not all come round to this view.