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Carter Economics

by Robert G. Wertheimer, Cambridge, Mass.*

Reviewing President Carter's economic policy after his first few months in office, Professor Wertheimer assumes a critical attitude particularly towards Carter's energy package and anti-inflation policies which, in his opinion, show serious flaws, limitations and lack of imagination.

President Carter won the election because of his dramatic attacks on the Ford economy linked with impressive promises that the economy in his hands would achieve less unemployment, prosperity and economic justice. Ford's insistence that the economy was taking a normal course of recovery not requiring much fiscal engineering was met by the argument of a Republican neglect if not deliberate encouragement of unemployment to hold down inflation and sluggish economic growth in spite of the claim of recovery. President Carter on his part promised a new urgent spirit of recovery and specific priorities serving economic justice and equity. Calling the tax system a disgrace it was to be reformed thoroughly; budget deficits would still be needed but the Federal budget would be balanced by 1981. A \$50 tax rebate for every person was to be distributed to give consumers immediate spending power to be used in the market and clear inventories. In turn, business would have to speed up production and investment putting to work many unemployed. Added public jobs would speed up the reduction of unemployment. President Carter and Chairman Burns of the Federal Reserve could see eye to eye in agreeing to create economic and financial conditions to make possible a rate of real economic growth of 6 p.c. in 1977.

Wet Blanket on Many of Carter's Promises

While the new Administration felt strongly that the job of a faster recovery was to be done by the private sector, business was not singled out for special stimuli assuming that renewed consumer confidence would move up expectations everywhere. The fiscal plan, however, built around a rising deficit did not create any business enthusiasm leading either to an inventory or investment boom. The fear of faster inflation due to

rising deficits, rising international raw material prices and the fear of ultimate price-and-wage controls put a wet blanket on many of Carter's promises. An economic side trend developed even though the Federal Reserve could easily provide the credit basis for business spending expansion. In this let-down the stock market declined by 5–8 p.c. from the December high of DJI 1000 in spite of a steady rate of interest and rising profits, and thus a mediocre economic climate continued.

The suspicion of business that Federal deficits would be rising was, of course, justified. The Ford deficit projected at somewhat above \$50 bn for fiscal 1977 was to grow to \$68 bn¹. In consequence, Treasury borrowing was expected to rise by another 10 bn in calendar 1977 to \$75 bn. While there was no imminent danger of crowding out private borrowers in credit markets at the moment, any faster recovery could bring on a tighter monetary situation. Already, demands for mortgage money, inventory financing, new plant and equipment spending, local and state borrowing and the Federal deficit to add loans to finance oil imports required \$330 bn not easily matched by the domestic savings flows.

A Halt to Inflation?

The concern of business about the possibility of price controls found a more than willing echo in unionized labor concerned about the threat of wage controls even though the Administration moved cautiously. It only suggested a voluntary "pre-notification" of wage and price changes to

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¹ Partly as result of the Carter Tax Package originally set at \$31 bn for tax rebates, minor tax changes and spending on public jobs for both fiscal 1977 and 1978 (now reduced to \$21 bn). A rise in total budget spending to \$416 bn in fiscal 1977 also was projected (against the Ford projection of \$403 bn).

"set the government on guard" to be able to neutralize new inflation threats if they should occur. Even this vague hint at some kind of wage-price-and-incomes policies precipitated an explosive reaction of Labor. President Meany of the AFL-CIO flatly refused any willingness to participate in such scheme claiming that the freedom of collective bargaining would be impaired by such reporting. In a recent modification of these ideas the government now is looking toward a coordination of labor-management cooperation in restraining inflation. Labor-management committees in most key industries are to be created which would promote productivity and eliminate obstacles to efficiency². Holding the increase of minimum wages to 20 cents per hour to \$ 2.50 instead of the proposed \$ 3.— was taken as minor inflationary measure though much criticized by union labor.

Concerning business the suggested reporting of price changes did not lead to an ideological argument — in fact many business leaders found the plan acceptable provided labor cooperated — but soon it became obvious that many major producers particularly of basic materials and industrial goods moved up prices. They willingly followed the suggestion submitted by economist Dr Rinfret "that they should protect themselves against some future squeeze between a price freeze and rising wages".

Inflation threats ever since Carter came to power have become the *bête noir* not only for the consumer but business as well. Among the engines of inflation in addition to the growing international commodity price inflation and crop failure reports budget deficits rank high. Obviously, the proposed expansion of the Ford Budget spending plan at \$ 413 bn to \$ 460 bn in fiscal 1978 added to these fears. Actually, in years of price stability such an expansion at 11.4 p.c. p.a. in a time of large unemployment would not loom to be out of line. However, in an inflationary period such as

² G. Meany and R. Jones, chairman of General Electric, agreed to serve in this voluntary plan designed to reduce the inflation rate by 2 p.c. by 1980. Sec. Marshall of Labor will start such a program on an industry-by-industry basis modeled on the Dunlop Construction Industry Stabilization Committee. Disappointingly, highest rates of inflation nevertheless continued in this field.

ours any Federal spending increases particularly if they have to be financed by deficits loom inflationary. The absence of any investment stimulus for business in the proposed tax package should be mentioned as added factor for a certain business indifference and concern about Carter Economics. The Carter Plan for Energy discussed subsequently only will add to inflationary fears. In conclusion, President Carter's approach to inflation leaves a great deal of uncertainty damping business investment spending plans and threatening the continuance of consumer confidence.

The Energy Trap

Conservation, costs and sacrifice in the field of energy are becoming our blood, sweat and tears now. After the loss of six valuable years because of Congressional inertia since President Nixon issued his clarion call for project "Energy independence" in 1971, something had to be done. However, the major emphasis on conservation as a solution seems to be completely out of line with the American tradition namely to solve a problem by a reduction of demand and consumption. The great American advance over the last 200 years was never built on curtailment and economizing but on growth and expansion. There is justified scepticism about the soundness of the proposed measures "to turn the energy problem around" apart from their inflationary implications. The President estimates that the proposed taxes will add no more than 0.5 p.c. to the rate of inflation. Actually, the ultimate inflationary impact might be much larger but equally significant, these calculations do not allow for further price increases by OPEC³. Dr Schlesinger having been made Energy Czar without necessary powers to back up his position can do little more than become an errand boy to persuade Congress to pass this legislation.

What the US energy problem really calls for are huge public and private investments in energy research, exploration and production (substituting

³ Already scheduled for July 1977. To add, the rounds of energy costs increases planned for the US will only encourage further price increases by OPEC claiming "to have their share in the new US cash bonanza for fuel".

KONJUNKTUR VON MORGEN

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capital for energy) and full Federal guarantees by price and output support programs for the output of non-conventional energy production in the future. These risky adjustments cannot be forthcoming without such guarantees over time. What we propose is to test the limits of the range of elasticity of demand for energy assuming that high enough energy costs will deter consumption. Such dilettante and dilatory approach (which at best could assist in a supplementary way as a holding action) to bring energy consumption in line with available resources — including vast imports — is bound to alarm business as well as consumer expectations. The great financial burden thus to be put on the consumer in a period of rising inflation will reduce his discretionary spending powers and confidence in the future so carefully encouraged so far. It is this new squeeze that worries also business and the financial sector.

President Carter proposes to make coal king again. Of course, we have ample coal but so we have oil shale, uranium, a large hydro-electric power potential apart from the exotic fuel sources of wind, the sun, geo-thermal powers, tides, waves and perhaps gravity and magnetism. Because of distant location, pollution and the great traditional strike potential in coal mining — and its principal use for electric power production in which we have no severe shortages — the principal reliance on coal may turn out to be a mistake. Under the given circumstances imports of oil and gas amply available for decades might still be the superior route until huge domestic investments can solve the energy problem⁴. Second best still would be to undertake an emergency program to search for continental and off-shore oil and gas with many opportunities for discovery still open. Conservation should focus on the technology of energy use pushing up its efficiency factor though this process will require also large capital outlays and decades to perform.

A Great International Tradition Sustained

As usual the international arena is playing a significant role directly and indirectly affecting the economy. In 1977 trade deficits will grow due to weaker export demand from the not yet recovered economies abroad and rising import needs of a faster growing American economy with raw materials prices still rising. In spite of deficits — at \$ 2.7 bn last February (cif) the dollar has remained much in demand and bank lending to non-oil Third World nations in need of means for oil import financing continues. In times of rising financial uncertainties worldwide the role of the dollar as traditional reserve currency is growing.

⁴ Provided efforts are put in comparable to the Manhattan Project in pursuit of the production of the atomic bomb.

Foreign investors and OPEC members increasingly turn to the US as haven for their financial surpluses and direct investment.

Concerning the freedom of trade, the President has taken an outspoken stand in favour of freer trade in our tradition developed over recent decades. He rejected the decision of the International Trade Commission requesting protection against shoe imports⁵. Carter is attracting the wrath of labor in not yielding to protectionist demands now spreading to other industries, too, such as textiles, garments, steel, glass, consumer electronics, etc.⁶ The presidential decision came easily. Carter and his team are for freer trade being fully alert of the reciprocity of this freedom as well as of the position of the US in world finances and economic leadership. While the cry for "orderly marketing" will, of course, not die down it will not be served by the replacement of the comparative advantage concept by a new principle of "fairness and equity" in foreign trade.

The Tax Package Retreat

The new enthusiasm of the Carter Administration to get the economy going, achieve less unemployment and larger economic growth, tax justice, superior management and greater productivity is all to the good. The emphasis how to execute these changes, however, the priorities to select and the timing begins to unfold a certain weakness in the entire approach to economic problem solving. Take for example the original economic stimulus package: to spend \$ 31 bn over 2 years partly as a \$ 50 quick cash rebate for everybody and as some tax reductions, public works program spending and as small increase in the business investment credit⁷. It was assumed that this would become the most effective mechanism to reduce unemployment and achieve the desired 6 p.c. real economic growth rate instead of the 5 p.c. that the normal course of the economy might bring about.

Not much thought was given to inflation assuming that the going rate of 4.5 p.c. was fully maintainable. The injection of \$ 10 bn into consumer hands immediately though to be financed by a corresponding increase in the Federal deficit was not considered to be inflationary because of existing anti-inflationary "safeguards" consisting of 7 mn unemployed and an industrial capacity utilization of 77 p.c. However, a rise in the rate

⁵ By the increase in duties from 10 p.c. to 40 p.c. for imports exceeding 240 mn pairs of shoes. We wish to negotiate, however, "voluntary" restraints with South Korea and Taiwan.

⁶ To write a new multi-fiber agreement to limit the growth of imports to the growth of the domestic market, etc.

⁷ In particular a \$ 4 bn public works jobs bill and \$ 9 bn in sewage treatment construction grants to the states.

of inflation late in the winter and spring 1977 overtook these convenient assumptions of a subdued inflation. Because of the weather, rising fuel costs, rising international commodity prices and an economy growing stronger than expected the rate of inflation moved up to 6 p.c. and above even before the enactment of the package. In consequence, the rebate and hence one-third of the stimulus package was dropped shrinking it to \$ 21 bn over two years⁸.

Doubts and hesitation on part of the Congress had made an easy victory or even success in this voting unlikely. The budget now avoiding added \$ 10 bn to the deficit is close to the earlier Ford projections. Concerning the size of the budget, the Congressional Budget Committee increased it by \$ 6 bn over the more conservative Carter concept still projecting an increase to only \$ 460 bn for fiscal 1978.

In the course of a few weeks President Carter proved to be very flexible shifting his priorities from reducing unemployment to avoiding rising inflation by an excessive budget deficit. His targets now are the same as Ford's and he gradually is realizing that our problem is inadequate tax revenues from a slowly moving economy. In contrast to election promises, the President is unwilling to take vigorous action either to reduce unemployment or to restrain prices and wages even in case of more rapid inflation. On the other hand the President will insist on selling his energy package to the public and Congress even though it will be inflationary. No other economic measures have been taken or are proposed that could be labeled Carter Economics (the anti-inflation program to be discussed subsequently). In fact, the Ford-initiated economic recovery is now running smoothly with growing employment, improved business investment and consumer spending related to large car sales and housing starts suggesting a 5 p.c. growth rate⁹.

Whither Unemployment and Inflation?

Concerning unemployment the President is gradually sharing views held by the Ford Council of Economic Advisers and Dr Burns, namely that we are dealing here also with a major structural problem — how to integrate millions of teenagers and women into the economy and how to respond to the unusually high entry into the labor force in consequence of the baby boom of 1946/60. No large employment-creating projects are under way to reduce unemployment by the millions by

direct work programs or otherwise. Carter wishes to create faster employment by the private sector. He hopes that a real economic growth rate of 6 p.c. p.a. responding to rising consumer and business spending will provide these opportunities at least to increase employment by 1.5–2 mn annually as it has happened since 1975. It is not expected, however, that even a prosperous economy based on consumer and business confidence will reduce the rate of unemployment much below 7 p.c.

In dealing with inflation, the presidential concern has greatly risen in recent weeks after underestimating at first the power of domestic and international inflation. On the one hand, the President had greatly overrated inflation restraints that the labor surplus and industrial excess capacities were to provide; on the other, he showed only limited understanding of the importance of the monetary mechanism and what it could contribute to the control of inflation. There will be an uphill struggle against the two interacting inflationary spiraling systems: the wage-cost spiral driven by average 10 p.c. p.a. wage increases in major union contracts and the domestic and international fuel cost spiral. The proposed anti-inflation program is disappointing proposing as a centerpiece the creation of labor-management committees in key industries "to promote productivity and eliminate obstacles to efficiency"¹⁰. As other measures an increase of the deficit over \$ 60 bn is to be avoided, energy tax revenues to be greatly increased and no permanent tax cut to be provided.

In conclusion President Carter can count on a 5–6 p.c. real economic growth rate, about 7 p.c. unemployment and 6 p.c. and above inflation, altogether achievements little different from what the Ford Administration had in the making¹¹. Among crucial decisions the maintenance of freer trade and reduction of government regulations and concern for productivity gains loom favorable¹² but the proposed "solution" of the energy problem and how to deal with inflation show serious flaws, limitations and lack of imagination. Let us hope that the proven flexibility of the President will help him to move the economy safely through 1978 and, thus, completing the third year of the recovery.

¹⁰ G. Meany and R. Jones, chairman of the General Electric Company, will serve in this set-up coordinating labor-management cooperation in restraining inflation. The Sec. of Labor will develop a corresponding program on an industry-by-industry basis modeled after the Dunlop Construction Industry Stabilization Committee. Disappointingly, construction turned out to become the most price-inflated industry in recent years.

¹¹ Also to mention the advocacy of zero-budgeting that is the introduction of a management system that would compel all federal agencies and activities to justify their continued existence.

¹² To add, a range of the stock market between a DJ average 900/1000 and slowly rising short term rates of interest limiting the increase in the prime rate to 7 p.c. late in the year.

⁸ Since this low, utilization now has climbed to 82 p.c. or only 1 p.c. below the long-term average from 1948 to 1975.

⁹ Explaining the change with "economy turned out better than expected" and did not need this stimulation to achieve 6 p.c. growth. Economist Eckstein dissented claiming that this retreat would reduce the GNP growth by 0.6 p.c. to 4.4 p.c. instead of the hoped-for 5 p.c. in 1977.