

Großer, Günter

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A Farewell to New Deal Economics

During the US electoral contest economic issues played a key role and there is hardly any doubt that they also decided it. The voter may have mostly been more interested in a protest against recession, unemployment and inflation than in an ideological turn towards the economic policy alternative of the challenger Reagan. However this may be – with his electoral victory he has obtained the mandate to realize his economic programme. Although this is mainly a question of American domestic policy, its direction and results are of extraordinary importance to the other countries. One need only look back: The world economic maldevelopments of the seventies did not begin only with the first oil price explosion. The world economic and monetary order had rather been shaken earlier, not least by the USA's failure regarding stabilization policy. On the other hand, progress in the battle against inflation and in the improvement of growth conditions in the USA would now significantly help to master the international economic adjustment problems of the eighties.

The new President will have little time for reflection. The last months' somewhat more favourable figures cannot gloss over the present unpleasant situation of the American economy. It is true, the rapid descent of demand, production and employment has not continued since the middle of the year. Here the correction of temporary downward overshootings appears to have played a role; certainly this does not mean that the recession has come to an end. But above all the problem of inflation is unsolved. The underlying rate of the price increase is still to be estimated at about 10 %, and the prospects for an early reduction are considerably compromised by the price-increase tendencies in the case of foodstuffs and the complete decontrol of oil prices to be expected in the next autumn at the latest.

The inflationary increase of sales and incomes that has been lasting for a long time in the USA hides a development in real terms where employed persons as well as entrepreneurs feel themselves to be losers. Thus a worker's real wage is lower today than ten years ago. But profit margins of the enterprises – net and adjusted for all inflationary effects – are also considerably smaller than during the sixties. This generally disappointing tendency must be seen against the background of the unfavourable development of productivity: Its increase has steadily flattened and for already two years it has even been decreasing. True, this was accompanied by a remarkable expansion of employment, but on the other hand the rise of unit labour costs and – since an accommodating monetary policy granted sufficient scope for the passing on of costs – the upward trend in prices were fuelled. From this point of view the raising of productivity appears to be an important prerequisite to check inflation. If however unemployment is again to be reduced simultaneously, a vigorous economic growth is required – above all a strong expansion of business investment.

The cyclical upswing until the spring of 1979 could not set in motion such a development. Obviously the improvement of sales and profit expectations did not last long enough. An

important role may have been played by the fact that the end of the upswing had early been preprogrammed in advance by the strengthening of inflationary tendencies. According to Reagan's economic philosophy, however, the cause of the investors' continuing restraint is ultimately to be found in the progressing restriction of private enterprise by the Administration. His economic prescription logically consists of the Federal Government's retreat on a broad front by the reduction of taxes and expenditures as well as the gradual abolition of government regulations in various spheres. The belief in the dynamics and stability of the private sector replaces the conviction of the necessity of government intervention as developed since Roosevelt's New Deal. The intensified orientation towards a supply-oriented policy has thus a strong ideological bias which resembles that of the British conservatives.

The course of the electoral campaign suggested however the question how consistent the actual policy of a President Reagan would be. For, in the endeavour not to appear an economic extremist his argumentation moved increasingly from the unorthodox to the conventional. The proposed tax programme relieving individuals much more than enterprises might even pass for being much more demand-oriented than Carter's bill. First statements after the election let us expect that this was not only campaign rhetoric but that in 1981, although probably not at the beginning of the year, vigorous tax reductions will actually be realized. All the stronger is the new President's compulsion to curtail also federal expenditures already in the next year, in order to make the economic policy reorientation appear credible.

However determined the new President may be to adopt this course – he will be able to do this only with the support of Congress. And here, in spite of the changed majority in the Senate, considerable doubts in the cooperation are called for when it is a question of making the demanded reduction of "waste" in government expenditures concrete. In view of the announced drastic increase of defence spending a considerable cutting down of civil expenditure would be unavoidable if during the next year a drastic rise of the budget deficit is to be avoided and the budget equilibrium aimed at for 1983 is not to appear, from the beginning, as wishful thinking in view of the planned vigorous tax reductions during the next three years.

All of a sudden the new Administration thus stumbles from the broad avenue of the campaign slogans on an only narrow ridge of policy action. On the one hand it must endeavour to win confidence in a minimum of time that the new orientation of economic policy will really improve growth prospects. On the other hand it must not underestimate the role of the meanwhile firmly established inflationary expectations as an obstacle on this road: Maldevelopments having emerged over a prolonged time-span can, by experience, also be corrected only slowly. And this is valid, too, if – as demanded by Reagan – monetary policy is steering a foreseeable course directed towards stabilization. Although British experiences cannot be applied automatically they doubtless are giving a warning message.

The world outside the USA has every reason to watch intensely the economic development in this country. The direct demand impulses linked with this development may not have the weight today that they once had. But the influence of the USA as the leading economic power is, if anything, even greater at a time when its currency is playing a key role in handling the international capital flows for compensating for the explosively grown imbalances of current accounts – a role that other currencies can hardly take over. This function would be disturbed decisively by a lasting failure in checking of inflationary expectations. Continuing sags in growth and employment in the USA would in their turn give a fresh impetus to protectionism. After the set-backs in the seventies the American voter's decision to try "simply something different" may give rise to sympathetic feeling in other countries. All of them, however, must realize that they will share the inherent risks.

Günter Großer