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Coming 1986 Downturn Could Trigger Serious Recession

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from the not-so ivory tower

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By Hyman P. Minsky

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In midyear 1982, the country was in a deep recession, which was exacerbated by the fight on inflation. The high interest rates of 1980-82 led to the collapse of the Mexican peso and contributed to the collapse of the Penn-Square bank of Oklahoma City. The Federal Reserve under Volcker met these crises in a fine fashion. Mexico received emergency refinancing and the immediate repercussions of the Penn-Square failure were contained.

Rapid monetary expansion and massive government deficits began at this time and are still continuing. The recession ended in November, 1982. The recovery which followed is now three years old. **The history of business cycles shows that expansions rarely last more than four years; history indicates that a recession should be expected to start in 1986.**

Unless reinforced by analysis, history is not a good predictor of the course of the economy. A multitude of changes have occurred since Reagan took office. Some were the result of legislation, while others were the result of an evolution of institutions and of the way of doing business in response to perceived profit opportunities. Our economic history is replete with financial crises, recessions, and deep depressions. Nevertheless, there has always been a utopian belief that if we only got things right we would achieve what Herbert Hoover characterized as "a new era of permanent prosperity."

The belief that Reagan had inaugurated an era of economic prosperity will collapse as the nation will reap the fruit of an imprudent policy.

Have the dramatic changes of the Reagan era created an economy which is conducive to permanent prosperity? The economy of January, 1981, which was mainly the legacy of the Roosevelt reforms of the early 1930s, was fiscally conservative. Even though expenditures were high the tax system was designed to balance the budget when times were good. Deficits were tolerated to contain and control recessions. By the criteria of not having a deep depression, the economy from Truman through Carter was more successful than the economy from Washington through Hoover.

A main policy innovation of the Reagan years was to abandon fiscal conservatism. Taxes were cut even as defense spending was accelerated. The stated hope was that accelerated "growth" would yield the revenues to finance spending even with the gutted tax system. The hoped for accelerated growth has not occurred; there never was any solid reason to expect that it would take place. A large structural deficit was the result: **the current deficit reduction bill is a gadget that evades the issues of fiscal responsibility.**

The great deficits of Reagan's first five years fed an enormous amount of government debt into the portfolios of banks, pension funds, insurance companies, households, and foreign holders. The need to facilitate the absorption of this debt forced the Federal Reserve to provide for an accelerated growth of available bank credit. The growth of the government debt to the $2000-billion range tended to unbalance private portfolios. Unless they did something, banks, etc. would have too much government debt. The something to do was to acquire private debt. The massive growth of government debt since 1962 has led to a strong market for the debt of business and households.

When the Reagan administration and a compliant Congress gutted the personal income tax, the supply siders argued that the decrease in taxes would lead to a rise in savings. **They were wrong; the decrease in taxes has led to a spending spree that has reduced the savings rate of out-of-household income to an all time low of 1.9 percent in September, 1985.** But such a spending spree means that households on the whole increased their indebtedness as a ratio to household income to an all-time high. Every day the financial press carries news of more corporate takeovers, of additional leveraged buy-outs, and of further creative uses of debt to finance business. The proposed sale by CBS of KMOX-TV, Channel 4, is a repercussion of Ted Turner's bid for CBS. Whoever buys Channel 4 will do so with debt. Corporate debt is also at an all-time high.

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Debt, whether of households or governments, has to be serviced. The jump in household and business debt over the expansion that began in November, 1982 means that a high percentage of household and business income of 1986 will go to service debt —just as a high percentage of the 1986 government spending will be interest on the government debt.

The increase in the rate of expansion of the economy in the third quarter of 1985 was largely due to the decrease in the savings rate by households. That source of accelerating the expansion is now used up and we can expect households to return to a more normal (5 or 6 percent) rate of savings. **This will mean that the rate of increase in household debt will taper off; there will be a fall in the debt-financed demand for automobiles and other consumer goods.**

A rise in the household savings ratio will have a strong negative effect on business cash flows. The increased indebtedness of business means that their cash flows are heavily committed to servicing debt. Any decline in demand increases the already heavy burden of debt and decreases the willingness and the ability of business to debt finance investment spending. It also is a signal to businesses and their bankers that a decrease in inventories should take place.

The massive increase in the federal debt after 1982 and the monetary ease that it required triggered a recovery. The growth of the outstanding Federal debt together with the incomes due to the Federal deficit created a strong demand for business and household debts. The corporate take-over, leveraged buy-outs, and the household spending spree supplied the debts. The result is familiar from our history; **we now have an economy that is vulnerable to an interactive process in which the debt burden, due to servicing requirements, reduces consumption, investment, and employment.** The reduced spending leads to lower incomes, lower incomes raises the burden of indebtedness, which further lowers spending, etc.

If this takes place there will be a replay of a familiar scenario. The collapse of wage income and business cash flows will be aborted by massive government deficits. The depth and the length of the recession depends upon how promptly and how forcefully the Federal Reserve and the administration intervene. If government spending contracts as this process takes hold, then the length and the depth of the recession will be increased.

Last year, at election time, the Reagan aura made many believe that a new era of permanent prosperity had been achieved. It is now clear that what prosperity we enjoy is not universal and is very tenuous. **As things stand, a modest downturn can be the trigger for a serious recession.**

Because of the accumulation of public and private debt, the economy will be in largely "unchartered waters" in 1986. It is still true that the most likely result will be a recession that will be contained before it gets to be substantially more severe than the recession of 1981-82. But the present is sufficiently different from the past so that an inept or reluctant policy will permit the economy to break through the barriers that have contained the recessions of the past 40 years. If this happens a recession that is substantially more severe than that of 1981-82 will take place. ■

Are TV commercials as bad as they look?

By Jarvis Rice

***Jarvis Rice**, a 30-year-ad agency veteran now retired, spent 15 of those years at J. Walter Thompson, Chicago.*

Worse, you say? Let's see if you feel the same way after reading this article. TV commercials *are* dumb. They're annoying, insulting, aggravating. But they're also clever, captivating, irresistible. Commercials are an awful nuisance. On the other hand, they're often better than some of the programs. Does *your* child leave his toys and hurry into the living room to see certain TV ads? It happens.

But many commercials *do* seem bizarre. I mean, if you've ever spread your bread with Imperial margarine, did you hear trumpets blare? Did a crown appear on your head? Or perhaps you're in the habit of donning your Blue Bonnet before sitting down at the table. Like Joe Garagiola did until the client couldn't stomach it any longer. Or are you in that strange group that *talks back* to the margarine container? Butter—margarine . . . butter—margarine—that idiot refrain.

Have you ever been hit in the face with one of those bras women were throwing out the window because they had found Playtex Cross Your Heart Bra? Do you believe the unforgiveable sins of modern society are underarm wetness and unruly hair? And that Mitchum deodorant and Flex shampoo will surely solve those ills? How many women *you* know go around showing their Underalls? ("Makes me look like I got nuttin' on at all!")

Those are just some of the commercials which over the years have been voted *most obnoxious* by juries of your peers. Yet, they have all attained excellent sales results. Take Anacin (for fast, fast, *fast* relief). One hated television spot—the one with the hammers in the head—was shown on the air for seven years at a cost of $86 million. But it made many hundreds of millions more than *Gone with the Wind* did in over 25 years. Maybe that is what inspired someone to scrawl on a wall this piece of graffiti: "Anacin is like a doctor's prescription—and it tastes like Beef Stroganoff."

Spell relief

Oh, the power of television commercials! A couple of years ago, the *Wall Street Journal* reported that a third grade class in a Connecticut school, given a spelling test, was asked to spell the word "relief" and over 50 percent of the class spelled it—you guessed it—R-O-L-A-I-D-S. Now, the Rolaids people have never spent a lot of money on their advertising production. They use corny techniques from the '50s, like writing on the blackboard, on windows with Bon-Ami, on baseballs, on pads of paper. Try to tell them they should spend a million dollars to update their commercials! Like that Coke commercial with all the movie stars, including Bob Hope. It cost a million, but now the Pepsi spot with Michael Jackson is reputed to have cost *five* million. (This figure could be just a press-agent's figure.)

Still, many commercials are frightfully expensive, and they're produced with the greatest of care, and edited to the nth degree. Just imagine! Sixty-five pictures of McDonald's breakfasts in one 60-second spot. I counted 125 scenes in a 60-second spot introducing new Fords, and it was completely readable. All this in the face of strict regulations, heavy censorship, all kinds of taboos and no-nos. The TV commercial—the thing you love to hate—has to overcome many obstacles before it ever reaches your living-room.

Some are of the producer's own making. Here is an example. A camera crew flies out to the Grand Canyon to shoot an airline commercial. They have with them a condor—a large vulture—to simulate flight. They release the bird from a high peak, as the cameras start cranking—and the bird falls to its death. Someone forgot to order a condor that could fly.

Extravagant production has included spokesmen leaping out of airplanes, products in hand. Timex may have started this cycle when they had a man lose his wrist-watch as he jumped. When they find it hours later in a farmer's field, it's still ticking. Remember *MAD Magazine*'s Timex Torture Test? They had a Mr. Asmus undergo it *with* his Timex. First, a fire truck blasts him with tons of water (Waterproof Test). Then hard hats pound him on the head with sledge-hammers (Shock Test). Next, the Anti-magnetic Test: A huge crane with an electromagnet lifts Mr. Asmus up by his suspender buttons and drops him in front of the announcer (John Camel Swayback) who says: "Powerful, eh? And now the Dirt Test." Fourteen tons of dirt and gravel slide out of a dump truck on top of the man. Only his hand flops out, showing his Timex. "It took a licking but it's still ticking," says the announcer. "Unfortunately, Mr. Asmus wasn't so lucky" —as the man is hauled away under a

continued on page 19