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1975 and Beyond

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In 1975 the strength, resilience, and reliability of the institutions and policies that have evolved, over the past forty years, in the effort to stabilize the economy will undergo severe tests. At this writing (January 1975) it is apparent that we are now into what might well be the most severe slump since World War II. The rapid rise in unemployment in November and December of 1974, together with the very high inventory to sales ratios in industry and trade, indicate that the decline will continue at ~~least~~ through the first quarter of 1975, and more than likely will extend into the second quarter. The likelihood is that the second half of 1975 will be a period of stagnation, rather than a period of recovery. Unemployment rates are almost certain ~~likely~~ to go above 8% in the first quarter, and to stay high throughout the year.

Government policies — both monetary and fiscal -- will respond and turn increasingly expansionary as the slump proceeds. Even though prices in the first half of 1975 will still be increasing at a historically high, though decreasing, rate, we can expect the emphasis in policy to shift towards expanding the economy. However, the financial situation that generally rules for business, banks, and other financial institutions imposes a sharp barrier against a rapid recovery. The type of action that was successful in fostering recovery from the earlier post-war slumps are likely not to do the job promptly in 1975.

The reasons why standard expansionary policies might not work quickly in 1975 lie in the uncomfortably illiquid positions of many corporations, banks, and financial institutions. At the end of World War II corporations, banks, and financial institutions were exceedingly liquid. In the first post-war period, which lasted until the late 1950's, the inherited liquid assets were used to finance investments by business and loans by financial institutions, including banks. Early in the 1960's this excess liquidity had been used. As this new situation emerged, corporations and financial institutions devised increasingly sophisticated and complicated financial arrangements, which enabled a continued, and because of inflation, an accelerated (in dollar terms) expansion to be financed. These much expanded debts, together with the traumatic carrying costs of debts in the 1970's, virtually stripped many units of their liquidity by the end of 1974.

Actual bankruptcies, such as that of Franklin National, and the continuing close calls with respect to bankruptcy, such as that of Pan-Am, mean that in 1975 we can expect business and banks to reconsider their desires with respect to liability structures. In good part we can expect that funds that accrue from income, debt repayment, and Federal Reserve actions, will be used to improve balance sheets rather than to finance income creating activities. Thus, even if aggressive government policy succeeds in propping up the economy during 1975, we should not expect a quick resumption of the expansionary private economy that ruled in the 1960's. The second half of 1975 and perhaps 1976 will be years in which the private economy stagnates; wise business men and bankers will use these years to consolidate their positions and firm up their finances in order to prepare for advances and expansion after their, and the economy's, liquidity position has been restored.

The above is predicated on an orderly quest for liquidity by business and finance. If spectacular bankruptcies occur, we might well see a 'panic' drive for liquidity, which would lead to a further sharp decline in income and employment. If additional financial trauma occur, unemployment rates might well approach 10% in the second half of 1975 and the process of restoring sufficient strength to finances, so that the private economy will recover, will extend beyond 1976.

Thus what we are most likely to experience in 1975-76 will in retrospect be called a depression, serious but more than likely not catastrophic. It will clearly be more severe than any of the earlier post-World War II recessions, but it will not be of the depth or last as long, as the Great Depression of the 1930's.

The depression of 1975/76 might well serve the same functions for the American economy as the great depressions of history: it might open the way to meaningful reforms, which strengthen the stability and improve the equity of the economy, and it might facilitate change in the composition of output. If one or both of these changes occur the composition of the expansion and growth of the economy that will take place after 1976 will differ from that of the period between the end of World War II to the early 1970's.

The view that the post-recovery future will differ from the quarter century after the end of World War II is reinforced by the changing relative price of energy. During the first two-thirds of this century, the falling relative price of energy was a dominant force in determining the nature of economic growth. In the last quarter of the twentieth century the course of economic growth will likely be dominated by the adjustment required by sharply rising real costs of energy. In response to cheap and cheapening energy, production techniques and consumption patterns developed that were prolix in their use of energy. The challenge we now face is to maintain improvement in well being while developing production and consumption patterns that radically reduce our uses of energy.

In a free market, this economizing on energy use would be directed by the price mechanism. In our economy, replete with taxes, subsidies, market imperfections, and direct government intervention, ~~wise~~ policy, if wise, will move to abet the economizing of energy. If policy takes the unwise tack of using government powers to offset the effects upon market prices of rising real costs of energy, then a severe impoverization of the less energy intensive dimensions of life will take place. We must, as a nation, understand that a radically different pattern of growth than that which ruled in the quarter century after World War II is, in the light of current realities, a better pattern.

Whenever the economy is at a watershed, as we are today, opportunities for innovative entrepreneurs exist. Because the last quarter of a century is likely to be markedly different than the first three quarters, we can expect that the country will need a new creative business leadership. The likelihood that future growth will be different from past growth provides opportunities, not only to creative business leadership, but also to innovative financial institutions.