States of the Union
RECESSION IS NOT A SOLUTION
BY AMITAI ETZIONI

The reason for this all-too-familiar pattern is the notion that, like an old locomotive, the economy cannot travel at a “faster” growth rate than roughly 2.5 per cent of the GNP without overheating and triggering high inflation. It is now running between 3-4 per cent.

In theory, it should be possible to slow down the economy without throwing it into reverse and suffering a ground-losing recession with a drop in the GNP. But there is good cause to beware. Past experience shows that the economy cannot be controlled so closely. Further, when the brakes are first applied, there is often little or no discernible effect, as in the present situation. The Fed then tends to step harder on the brakes until it is discovered—invariably, too late—that we have been pushed into a recession. Finally, economists of Greenspan’s bent would rather “buy” a setback (a mild one, they hope) to “cool” things off than risk a possible runaway inflation.

Indeed, a warning light is already on for a recession in 1989 or 1990. We now have what is called an “inverted” (or abnormal) interest rate curve, with short-term rates higher than long-term rates. This phenomenon has occurred 22 times since the Civil War. It has been followed 22 times by a downturn in the economy, on average a year later. Fasten your seat belts.

Unfortunately, recessions are a much overrated cure. Their effects rarely last more than two to three years, since they do not change either the structure of the economy or people’s values and habits in a lasting way. Typically, they stall inflationary inclinations only temporarily. The 1970 recession brought prices down in 1971-72, but the 6.2 per cent inflation rate of 1973 exceeded the recession level of 5.9 per cent. By 1974, inflation reached 11 percent. That led to a new induced recession, which in turn was followed by yet worse inflation—11.3 percent in 1974, and 13.5 per cent in 1980—and still another recession. (The 1981-82 recession did not give way to high inflation because of exceptional circumstances, notably the collapse of OPEC.)

Similarly, there are no grounds for believing a recession would deal with the basic factors that have created the U.S. trade imbalance. On the contrary, while it would provide temporary relief (by cutting consumption and thus imports), a recession would undermine the nation’s ability to build up capacity, the only long-term remedy for trade imbalances. It would also cause investment plans to be curtailed, discourage workers who seek retraining, and so on.

The economic costs of a recession, in fact, are massive. In 1989, for example, instead of advancing 3 per cent or better, the GNP would be driven into a decline (it fell 2.5 per cent in 1981-82). The one-year “shortfall” could easily amount to $100 billion. Moreover, the loss would affect all subsequent years, because the post-1990 economy would resume its expansion from a lower base. In other words, even if growth returned to 3 per cent in 1991, it would be 3 per cent of a GNP that is, say, $100 billion smaller. A GNP slice lost to recession can never be recovered.

The Federal Reserve under Chairman Alan Greenspan is well on its way to inducing yet another recession, for no good reason. Greenspan has put the brakes on the economy by raising interest rates again, with the result that short-term rates are up 3 per cent over a year ago. The latest twist came last February 23, when the Fed raised its charges for lending banks money to 9.5 per cent and some banks increased their prime rate to 11.5 per cent, the highest since the end of 1984.

AMITAI ETZIONI, university professor of sociology at George Washington University and the author, most recently, of The Moral Dimension, is spending this academic year as a visiting professor at the Harvard Business School.
The human costs of a recession are very severe as well. A decline in the GNP would, of course, be paralleled by tax revenue losses and increased unemployment and welfare outlays. A 1 per cent advance in the GNP, on the other hand, would yield enough tax revenues and savings in expenditures to fund the token Bush Administration initiatives in education, environment and housing. In addition, we would spare millions of Americans the stress (not merely financial) caused by being thrown out of work through no fault of their own.

Studies conducted at Johns Hopkins University show that during a recession there are dramatic increases in marital breakups, admissions to mental hospitals, suicides, and mortality. According to one calculation, the annual toll of a recession would be upward of 17,000 deaths, 200 more suicides, 6,000 new mental patients, and 400,000 more arrests. Because the impact of such devastation lingers, the total human toll is substantially higher—e.g., 75,000 deaths (due to stress) are projected, using the 1980 population base. And American recessions generally slow down the economies of smaller nations, contributing to more losses and suffering.

But what about inflation? It is true that whenever too much demand (dollars “wishing to buy”) is chasing too little supply (goods and services), inflation rises. It does not follow, however, that the only solution is to cut demand; we could, rather, increase supply. During the Kennedy era, the U.S. economy was racing at an annual growth rate of 6 per cent or better, and inflation stood at 1.3 per cent or below. We need not crawl to keep the heat low. Granted, today we are less competitive, but that simply means we have to revitalize the economy so that it can again tolerate a faster pace.

Greenspan may understand all this, yet there is little he and the Fed can do on the supply side other than keep interest rates down. Our recent experience has demonstrated, though, that lower rates without suitable accompanying measures would lead Americans to consume more—not invest more. The task of redirecting the country’s national resources toward economic rehabilitation, therefore, is in the hands of the Executive and the Legislature. As usual, the President and Congress are concentrating on one problem at a time where the domestic economy is concerned, and at the moment they are preoccupied with the deficit. They are also chained to a free market ideology that objects to the structural policies required to “update” the economy.

That is not to suggest there is full agreement on precisely what should be done even among investment-side economists like Lawrence Summers, Lester Thurow, Robert Reich, and Rosabeth Kanter (most of whom are Democrats and were supporters of Michael S. Dukakis’ bid for the White House). Nevertheless, some of the steps we have to take seem clear.

First, we must increase savings and investment. The best way to achieve this goal, in my judgment, is not to grant the rich one more tax break (in capital gains) but to take Social Security out of the unified budget, where its rapidly growing surpluses are being used to reduce the national deficit. The surpluses, which run into hundreds of billions of dollars, should be invested in a portfolio of Federal and corporate bonds, to increase investments vastly and rapidly (assuming the Federal deficit will be reduced).

Second, there has to be a curb on corporate takeovers and buyouts, to shift resources from speculation to investment.

Third, we need to vastly increase both private and public investment in research and development.

The nation must engage, too, in a much more assertive trade policy, to open markets now closed to us. We need to invest more in the infrastructure (to fix obsolete roads, ports, rails, etc.). Other necessary structural corrections will readily present themselves once we turn our minds to the question of how we can make the economy travel more rapidly, without overheating.

It might be said that what I have outlined is a Democratic agenda. Well, President George Bush has embraced so many Democratic positions that one more would not hurt him, and would benefit all of us.