the business outlook for 1973*

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Continued Expansion in 1973 amid Growing Prosperity

THE POLICY INPUT

The grand design for the years immediately ahead is to promote sustainable economic growth without renewal of the serious problems facing the first Nixon administration. Conditions are favorable, and the will and intent are evident. Let us briefly contrast January 1969 with the present. In 1969, the inflation rate was high and accelerating. Inflation has now been receding for 2¾ years to less than half peak levels. Three years ago the economy faced excess demand pressures with little room for real growth, in contrast to considerable excess capacity at present. The dollar was then weakening in international markets but is today regaining preeminent status among the world's currencies. The Vietnam war was intense with little prospect of ending, versus a vision of imminent peace at this time. Financial markets which were in turmoil are manifesting growing stability and strength. Policies of restraint and radical change were appropriate for those prior serious problems. Today a strategy of stable and moderate stimulus could produce unparalleled prosperity.

Furthermore, recent policy innovations justify guarded optimism. For the first time in the history of the Federal Reserve system, objectives and operating techniques are couched primarily in reserves and money supply terms rather than in vague money market conditions and interest rates. The earlier attempts by the Federal Reserve Board to focus on short-term interest rates led to volatile monetary growth which induced stop-go economic performance. Moreover, resisting interest rate increases from 1965 to 1970 often resulted in excessive monetary growth which exacerbated the inflation and associated problems. Since January of this year, the Federal Open Market Committee has shifted toward a reserve target, and results have been encouraging. Rising interest rates this fall did not result in a spurt in monetary growth as some feared. Monetary growth in the past year has been 7 percent, in the past 6 months the money supply has expanded at an annual rate of 7 per-

* Presented at the Annual Business Forecast Luncheon, sponsored by the University of Chicago Graduate School of Business and its Executive Program Club, at the Conrad Hilton Hotel, December 12, 1972.

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cent, and during the past 3 months the rate has been only 5.3 percent.

A 6 percent rate of money supply growth may be appropriate for now, but if continued indefinitely, somewhat higher inflation could follow. The long-term potential for real output is near 4 percent; and if inflation is to recede to the 1–2 percent rate, growth in the money supply should gradually decline to about the 4 percent level. But an effort to restrict sharply the rate of monetary growth could impair the expansion in 1973. It is our best judgment that in the year ahead the money supply will continue to grow but at a slightly lower rate, approximating 5 percent. As a monetarist who is convinced that money greatly matters, this view of prospective monetary policy is critical to our optimistic view of the years ahead.

The major unresolved problem in domestic economic policy is federal budget control. Budget deficits appear to be a permanent habit. Inevitably, pressures to spend exceed existing revenues. This tendency is aggravated when the voters believe the relation between federal spending and taxes is tenuous, or that if more revenues are needed to finance federal programs someone else will pay the higher taxes. However, even here some progress is evident. The administration has chosen to fight on the $250 billion line. The president has threatened to use vetoes, withhold authorized appropriations, and avoid tax increases. A reelected president with a 61 percent majority can bring strong pressures to bear. Furthermore, Congress recently authorized a Joint Congressional Committee for the purpose of looking at the total budget and making sure the individual pieces are consistent with resources available. The attempt to prune unsuccessful programs, reorganize the executive office and congressional budget procedures, and eschew massive new initiatives will be accompanied by acrimonious debate, but I believe progress will ensue. There is no such thing as a free lunch. Either we pay for government programs with revenues or with inflation. Restraining federal spending will not impair the expansion, as some prominent economists contend, but will reduce the inflation threat and release more resources to the private sector from which jobs and profits arise. We therefore are assuming that the spending thrust from the federal government will substantially abate in the year ahead.

But what about controls? As predicted a year ago, real growth accelerated and inflation slackened somewhat further even though most of the inflation progress occurred prior to August 1971. Unfortunately, many observers attribute this happy set of events to controls and welcome either continuation or even tightening for the future. Although the controls have been an unqualified political success, it is my judgment that reduction of inflation was brought about primarily by the elimination of excess demands during the 1969–70 recession. Most experiments with wage and price controls have led to serious shortages and extensive resource misallocation. In the main, such a pattern has not developed this time due to the existence of capacity relative to demand. Even so, the very strong lumber market has been marked by shortages, black markets, and the usual accompaniments of controls. Also, profit margin restraints are becoming increasingly inequitable, and signs of inefficient expenditures to lower margins are appearing. If controls are continued in the present form for another year amidst gathering strength in product and manpower markets, serious damage to the economy could occur. The sooner we get back to freer markets, the greater the confidence I will have in the future. Unfortunately, vested interests are rapidly developing around the control program. Businessmen sometimes favor them because of inherent protection from labor and aggressive competitors. Consumers want controls because many believe they will protect their dollars. Elimination of controls will not lead to resumption of accelerating wage and price pressures provided monetary-fiscal policies are properly managed. If they are not, the controls will not save us in any event. The proper action for the president, in my opinion, would be to declare a victory and withdraw promptly before serious damage occurs. However, our expectation is that the control program will remain, but its extent of coverage will be further reduced, and profit margin restraints will be eased.

ANOTHER EXCELLENT YEAR

The present momentum of the economy, the lack of serious imbalances, and the prospect for steadier policy input indicate another excellent economic performance in the year ahead. Total GNP is expected to rise 9.1 percent to $1,255 billion, with inflation accounting for 3.3 percent of the rise and with real output increasing 5.8 percent. Consumers, business, and government will all share in the increase. Consumer outlays are projected up by 8.8 percent to $783 billion, with durables leading the way. Gross private domestic investment is expected to increase 10.1 percent to $196 billion, with inventory accumulation accelerating to about $10 billion, producers durable equipment outlays rising further to $88 billion, and housing tapering off slightly to $53 billion. Growth in state and local outlays will accelerate to a 12.1 percent growth rate reflecting lessening budget restraints and strong voter demands. Federal expenditures on GNP accounts are expected to rise only slightly to $109 billion. The net export deficit will decline from $4 billion this year to an approximate balance in the year ahead. Unemployment is expected to average 5 percent and end the year slightly below that level. On the whole, the odds are very high that another excellent year looms ahead.

INTERNATIONAL PROGRESS AND FINANCIAL MARKETS

Although the balance of payments remains in deficit, the dollar is stronger and the prospects for further improvement are bright. Furthermore, due to the international initiatives of the Nixon administration, we already have an international monetary system far superior to Bretton Woods, and prospects for further improvement are promising. Bretton Woods contained no disciplinary or adjustment mechanism which restored balance-of-payments equilibrium once imbalance occurred. Nations refused to adjust their domestic economic activity due to understandable desires to promote maximum employment. Exchange rates were pegged, and most nations resisted either devaluation or revaluation as long as possible. Hence, the system was subject to recurring currency crises. Today, currencies may fluctuate 2¼ percent on either side of par as a result of the Smithsonian agreement, and countries are now more prone to float their currencies—at least in the short run, when they come under pressure. Also, the United States is no longer charged with converting dollars into gold.

Last October Secretary of the Treasury George Shultz, former dean of the Graduate School of Business and former chairman of this panel, presented an excellent blueprint for further improvement of the system. The pith of the proposed system entails even more exchange-rate flexibility, discipline for surplus as well as deficit countries, and designation of reserve flows as the trigger mechanism for promoting exchange adjustment. In essence, he proposed flexible exchange rates and stable reserves for the prior unstable system of fixed rates and variable reserves.

Finally, the prospects for further strength in the dollar are excellent. The delayed effects of the 1971 devaluation of the dollar are now evident. Exports are growing, imports are being restrained by higher costs of foreign goods, and capital flows are tending to come our way with the exception of current speculation of another revaluation of the yen. Although our inflation remains serious, it is one-half to one-third of the inflation in most of the developed nations. Also, their monetary growth, the basic cause of inflation, is much larger than in the United States. It has become conventional wisdom to deprecate the dollar in recent years and praise the wonders abroad. Let us not fail to recognize renewed strength at home amid growing problems abroad. The Nixon thrust toward freer and fairer trade promises to provide additional benefits to U.S. citizens as well as to the rest of the world.

Some contend that, despite the improvements previously stressed, 1973 will usher in another period of very tight money and credit crunch. I believe such a conclusion is unsupported either by the present environment or the outlook for 1973. True, a continued economic advancement will stimulate demand for credit, especially in short-term markets. But a crunch environment is missing, and monetary policy is expected to remain moderately expansive. Inflationary expectations are the prime force impacting long-term rates, and for reasons previously stressed accelerating inflation is not in view if monetary-fiscal policies develop as projected. We expect a moderate rise in short-term rates in the year ahead but little change in long-term rates. Equity prices should continue the present upward trend on average in response to higher corporate profits, stable long-term rates, and a moderately expansive monetary policy.

In conclusion, the odds are high that 1973 will be another excellent year. But this does not mean there are no risks of failure. A package of Washington policies well designed to convert a rosy promise into disaster would include: (1) no progress in controlling the budget, (2) a rapid growth in the money supply as an interim aid to budget financing or (3) a sharp decline in monetary growth in an attempt to quickly eliminate the inflation, and (4) a tightening of the control program in response to political pressures. The prospect for such developments are low, but the costs would be high if they were to occur. The administration is well aware that the economy should not approach the full employment zone at an accelerating rate of expansion. This pattern did develop in 1965, and we are still paying the price. The object is to promote sustainable growth and, in my opinion, policy inputs are well designed to accomplish just that. The recent appointment of Secretary Shultz as the chief domestic and international economic policy maker improves the probability of ultimate success. Conditions and policies are propitious for achieving uninterrupted prosperity for a long period ahead. The private economy is inherently stable. Let us hope that this time we avoid serious disruptions emanating from the Washington policy scene!