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"It Was the Best of Times and the Worst of Times"

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"It Was the Best of Times and the Worst of Times"

By John O. Bornhofen

"It was the best of times; it was the worst of times." These words penned long ago are especially true with respect to today's economic situation. Our current expansion is now almost four years old. Only two other postwar expansions have lasted this long. But strains are beginning to show. For some of us in the United States, the economic times couldn't be better; for others, they couldn't be worse. That disparity aside, there are other factors that make the current situation perplexing. Not surprisingly, there are a number of questions in the minds of many Americans. Are we sliding into recession? Is inflation about to worsen? Will the twin deficits improve in the near future?

It's been many years since the course of the economy, both current and future, has been as uncertain as now. If we look at one situation or indicator, we see the expansion either continuing or about the resume. Look at another, and we see recession or stagnation. This confusion is due to the expansion and contraction that are occurring simultaneously. While some industries and areas of the country are growing, others are wallowing in recession. And in some cases, such as agriculture, there is no relief in sight.

It is almost impossible to find another time when the economy was so unbalanced. In the past, one could always find an industry or section of the country going counter to the national trend. That's part of the "capitalist dynamic." But now we see a situation where the East and West Coasts are faring much better than most of the rest of the country. With pockets of exceptions, the economics of these areas are growing. For them, the expansion continues.

It is a different story in much of the "heartland." In an area from the Mississippi River to the Rockies, and from the Canadian border to Louisiana, much of the South, the Great Plains, and the Southwest are in recession. The reasons vary from area to area, but among them are low and declining prices of farm produce and farmland, low oil prices, weak demand for lumber, and weak mining activity. Unfortunately, there are several intertwined root causes that are difficult to deal with. Among them are the Federal deficit, erratic oil prices, declining industries suffering from high wages and inadequate productivity, structural change, increased foreign competition, and worldwide oversupply in agriculture.

A Growth Recession

All this has combined to bring national economic growth almost to a standstill. Real Gross National Product grew at a seasonally adjusted annual rate (SAAR) of only .6 percent in the second quarter. Thus, we could now be in a growth recession. Last year around this time, it also appeared that we might be going into a growth recession as real GNP growth averaged less than 1.5 percent per quarter for the last three quarters of 1985. However, these numbers have been subsequently revised upward, and it now appears that real growth was 2.8 percent SAAR for that period. Thus, the expansion continued. So far this year, growth has been slower, averaging 2.4 percent per quarter.

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Much of the uncertainty and some of the regional disparity has been brought on by the erratic oil prices in the past year. In mid-November of last year, they started falling. This promised fortuitous economic results. Then as abrupt as the decline, another OPEC agreement to allocate and cut production ended the chaos within the organization and sent oil prices up again. While the benefit to U.S. consumers of low gasoline prices hasn't been wiped out, the U.S. drilling industry has. The oil price decline lasted barely long enough to destroy the incentive to explore for and find domestic crude oil supplies in the U.S. Then prices went back up, but nowhere near their previous highs. The net result was to knock out our exploration and drilling industry and drive up unemployment in Texas, Oklahoma, and Louisiana. In spite of the recent rebound in oil prices, the great uncertainty about future prices continues to hold exploration down.

By the time the worldwide oil glut is over, the U.S. industry will be flat on its back and our dependence on foreign oil will be higher than ever. At that point — not too many years down the road — it could take years and a couple hundred billion dollars to rebuild it. Had the price decline been in place longer, the benefits of lower oil prices would have been greater. In retrospect, they were down long enough for us, as a nation, to bear the short-run costs, with little in the way of long-run benefits.

The accompanying precipitous decline in demand for petroleum-related capital equipment has contributed to a reduction in real expenditures on business fixed investment, the only major expenditure to decline so far in 1986. Personal consumption expenditures, government expenditures (all levels), and exports and imports are up so far this year (in real terms).

Around the country, some industries are expanding while others are flat or contracting. Home construction remains strong, while nonresidential construction is weak and might get weaker when the new Federal tax law takes effect. Agriculture is on its back having been hit by just about every possible misfortune (at least in some areas of the country). Overall factory output has been sliding recently, with the durable goods sector the weakest. Overall capacity utilization is dropping and, in the high 70s (per-

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cent), is well below the highs for this expansion achieved in mid-1984. Overall, industrial production is well below that achieved at this stage by the postwar expansions of similar duration.

Labor Market Stagnating

Along with these developments, the situation in the overall labor market has been stagnating in recent months. Although there have been a million new jobs since January, and although there is an obvious and growing shortfall of workers in minimum-wage service jobs, the overall unemployment rate has virtually been unaffected. At 7 percent, the unemployment rate is essentially where it was a year ago. What economic growth we have had has been too low to push the unemployment rate down.

One sector of total demand that is expected to be lower over the near-term is business investment spending on plants and equipment. The recent decline will probably continue, and could even accelerate, in the near future due to the pending changes in the tax law that repeal the investment tax credit on new investment and render unprofitable real estate construction strictly for tax-shelter purposes.

The other sector of the economy that is still deteriorating is the foreign trade sector. Imports are still rising far more rapidly than exports, and are currently averaging $150 billion above exports. Even with the lag implied by the "J" curve (whereby net exports fall for a while after depreciation has its effect), the deficit is too large and still growing.

There are several reasons for this growing deficit. First, the 30 percent depreciation of the dollar we thought had occurred was really much smaller, closer to 6 percent, when the dollar is priced in terms of the currencies of all our current trading partners. The 30 percent decline was calculated against the currencies of the countries that were major trading partners in the mid-1970s. Many of our new trading partners, such as the newly industrialized countries of Southeast Asia (Hong Kong, Singapore, Korea, and Formosa), have currencies that have depreciated in step with the dollar. Our imports from them have continued to rise. Also, the German economy remains sluggish, and the Japanese economy may be in recession due to the rise in the value of their currencies in terms of the dollar. Thus, their demand for our goods remains slow. Pleas by the Administration to their policymakers to stimulate their economies have, in the case of Germany, fallen on deaf ears and, in the case of Japan, have yet to be implemented. Faster growth in those countries would increase U.S. exports and lessen our trade deficit.

Another reason U.S. imports are holding up is that the Japanese producers have been trying to hold the line on their U.S. prices to maintain market share, rather than raising their prices as called for by the rise of the yen and the mark and the depreciation of the dollar. But, make no mistake about it, the massive rise in the value of the Japanese yen has hurt Japanese competitiveness and appears to have brought on recession there.

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Facilities Management Awards

The International Facilities Management Association (IFMA), an international association of over 3,500 professions in the Facilities Management area, has announced its educator of the year and student scholarship awards for 1986.

Robert D. Vrancken, Director and Professor of Facilities Management in the Seidman School of Business, has been selected as the recipient of the IFMA educator of the year award. The selection was based on his success in teaching the Facilities Management program at Grand Valley State, in research and publications, in presentations at formal seminars, and his development of the first facilities undergraduate program in a business school.

Kate Jarman, a graduate student in the Seidman School, has been selected to receive a five hundred dollar student grant. Ms. Jarman was selected by judges who reviewed submissions from senior or graduate level students enrolled in a full-time degree-granting facility management program at an accredited college or university.

The awards were presented at a meeting of IFMA in Chicago on October 27, 1986.

F.E. Seidman Distinguished Award in Political Economy

Amartya Kumar Sen

Dr. Amartya Kumar Sen, Drummond Professor, Political Economy at Oxford University, received the 1986 Frank E. Seidman Distinguished Award in Political Economy. The award, which carries a stipend of $10,000, is given annually to an economist who has distinguished himself or herself by contributing internationally, in the judgment of his or her peers, to the interdisciplinary advancement of economic thought as it applies to the implementation of public policy. Previous recipients of the award have included Gunnar Myrdal, John Kenneth Galbraith, Kenneth Boulding, Thomas Schelling, Arthur Burns, Arthur Okun, Albert Hirshman, Richard Musgrave, Janos Kornai, Robert Solow, James Buchanan, and Gary Stanley Becker.

The award was established by Mr. and Mrs. P.K. Seidman in 1974 in honor of Mr. Seidman's deceased brother Frank E. (for whom the business school at Grand Valley was named). The award program is directed by Mr. Mel G. Grinspan, Distinguished Service Professor, Department of Economics and Business Administration, Rhodes College in Memphis, Tennessee. Dr. Richard Gonce, Professor of Economics in the Seidman School of Business, attended this year's banquet which took place in Memphis on September 18.

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Lastly, many of the Lesser Developed countries are still in the throes of austerity programs and are under pressure to export as well as hold down their imports.

Disinflation May Be Ending

With the recent increases in oil prices, our brief bout with deflation has come to an end. Because of declines in the Consumer Price Index (CPI) in February, March, and April, inflation was close to zero through July, but now the CPI is rising again. Producers' (wholesale) prices continue to drop but at a much slower rate than earlier this year. This reflects the oversupply of basic materials and agricultural products around the world, as well as the earlier fall in oil prices. Lastly, the "Implicit GNP Deflator," sometimes called the "general price index," has risen at a slower rate this year so far than in any full year in well over a decade. With the recent oil price rise, the depreciation in the value of the dollar, the continuing strong demand for goods and services by the American economy, and our rising unit labor costs it is anticipated that disinflation will soon be over.

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In the financial markets, however, it appears that the long decline in interest rates might not be over yet. The recent stalling of rates of three-month T-Bills at around 5 percent and long-term T-Bonds at 8 percent has reflected the unwillingness of the Federal Reserve to push rates lower without coordinated rate cuts by Germany and Japan, and the fear in our financial markets that disinflation is just about over, perhaps for good. While they were falling, interest rates were driving the stock market as well as the bond market. Now the second leg of the "Bull Market of the 1980s" appears to be over, and the major indexes have again retreated from their highs. One part of that retreat was a spectacular and scary 86+ point drop in the Dow Jones Industrial Index on September 11.

One reason why the interest-rate decline may have further to go is the Federal Reserve's abandonment of its anti-inflation policy and its determination to avert recession by pushing interest still lower if need be. Of course, Federal policy has been expansionary for some time now, but the time may not be ripe to stabilize interest rates and money growth, so as not to reignite inflation. The Federal Reserve continues to want to err on the side of ease. Indeed, since February, the Federal Reserve has cut the discount rate four times — from 7.5 to 5.5 percent — and has brought about a whopping 18 percent increase in M-1, the basic money supply. While this increase is disturbing, it is difficult to tell how stimulative it will really be since the basic medium-of-exchange aspect of M-1 (currency and checking account balances) has grown only at an SAAR of 8.75 percent since December 1985, while the "other checkable deposits" aspect (NOW accounts, ATS balances, and Super NOWs as well as Credit Union share draft deposits) has shot up at a 22+ percent rate (SAAR). The problem is that much of the latter are really savings-type instruments with much lower rates of turnover than currency and checking accounts and are used much less frequently in transactions. They are not medium of exchange to the extent that currency and demand deposits are and therefore do not have the same potential for being inflationary.

Another reason our interest rates may have stopped falling is that the dollar is much more expensive to the Japanese now, and that should curtail come of their lending to the U.S. in the future. Still another major factor holding interest rates up is the growing disillusionment in the financial markets regarding the effectiveness of the Gramm-Rudman bill to cut the Federal deficit. The Office of Management and Budget now expects the fiscal 1986 deficit to be a record-breaking $247 billion. The estimate for 1987 is for the deficit to drop to $166 billion. That huge drop would be the biggest in history if it were to happen, but it's unlikely for several reasons. First, the projected deficit is based on overly optimistic assumptions about the course of the economy, tax collections, and governmental expenditures. Second, it is partly based on sales of federal assets that might not occur or might not bring in as much as expected. A sale of assets will reduce the deficit, but it is equivalent to "selling the house to pay the caterer." In addition, the latest deficit reductions discussed in Congress are basically done with "blue smoke" and "mirrors." The actions contemplated include just about everything — except raising tax rates and cutting expenditures. So much for Gramm-Rudman! We're back to expecting huge deficits in the future as far as the eye can see. The only certainty with fiscal policy is that the direct stimulus provided by the Federal deficit will be less in the near-future than in the recent past.

Probability of Recession Low

In recent months, there has been a lot of talk and speculation about a recession in the near-term. But for several reasons, the probability of this happening in the next six months is relatively low. A recession at this time would impact adversely on many individual firms and sectors of our economy as well as on those of the developing countries south of the border that are struggling with large external debts, primarily to our own banks. In addition, the farmers and the auto, steel, and other manufacturing industries would be hit harder. For these and perhaps other reasons, the Federal Reserve's monetary policy in recent months has been focussed on fending off recession.

There are still several factors that point to recession, however. Among these are the direct reductions in Federal fiscal policy stimulus that will come from reducing the Federal deficit. Another contractionary nudge could come from the new tax bill just enacted. Although some aspects of the bill will prompt greater spending, some provisions as well as the timing of the changes could temporarily depress economic activity in the short run, even if the long-run effect of the bill is positive. To some extent, these contractionary forces will be countered by the monetary stimulus that has been provided by the Federal Reserve, by lower interest rates, and by the increased demand for domestically-produced goods stemming from the past, and possibly future, dollar depreciation.

Thus, the odds are against a near-term recession, although it cannot be ruled out. As indicated, the forces auguring for recession should be dominated by the

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forces against, including the determination on the part of the Federal Reserve to do what's necessary to keep recession from happening.

In Michigan, we have been bumping along with economic activity up slightly on a year-to-year basis. The near term should see economic activity in the state continuing to be erratic with a little growth. This will follow a strong September due to the incredibly successful incentive program (2.9 percent rates on some new car purchases) by the auto companies. However, to some extent, this short-term success will hold down sales in the near term.

Seidman School Faculty Notes

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an article entitled, "The Clear Need for Facilities Managers" published in the March 1986 issue of *The Office Magazine*. He also presented a paper entitled, "Improving Human Performance" at the April 1986 meeting of the National Society for Performance and Instruction in San Francisco and presented a paper entitled, "Facilities Management and the Design Professional" at the July 1986 meeting of the Orlando Chapter of the Institute for Business Designers.

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Mr. Donald Williams, Sr., Director of the Seidman School's Minority Business Education Center, spoke on "The Changing Workplace and Its Effect Upon the Classroom" at an October 1986 Career Education Telecommunication Seminar which originated in Detroit and was transmitted to five sites in Michigan. He also presented a paper entitled, "Black Students on a White Campus" at the National Association of Black School Administrators.