
Murray L. Weidenbaum
Washington University in St Louis

Murray Weidenbaum examines the economic prospects for 1981 and what issues the Reagan Administration will be facing in its first year.

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THE UNCERTAIN RECOVERY IN 1981
THE CARTER LEGACY AND THE REAGAN OPPORTUNITY

By Murray L. Weidenbaum
Director, Center for the Study of American Business
Washington University, St. Louis, Missouri

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It is a real pleasure to have the opportunity to examine economic prospects for the coming year, the first year of a Reagan Administration. In a burst of nonpartisanship, I would like to note that it is unlikely that all of our economic ills will be cured in the coming 12 months, or in the next four years. But we now can see the opportunity for real progress. The key question in the economic outlook is, of course, whether the recovery now underway will peter out in its infancy in 1981 or whether it will fully develop next year. The answer may depend in part on luck. But, to a large degree, it will depend on how quickly Ronald Reagan can overcome the bitter economic legacy which will be bequeathed to him by Jimmy Carter.

Where We Stand

A few economic facts are clear. We have experienced a short but painful recession in 1980. The expansion now underway is neither broad-based nor hardy. It is confined mainly to the consumer sector, housing, and national defense, although high and rising interest rates are now making precarious the continuation of the recovery in homebuilding and in such consumer durables as autos.

Looking at the weaker sectors of the economy, surveys of business investment outlays show that this vital area will be hard-pressed to keep up with inflation during the year ahead, especially if 1981 turns out to be a
period of expensive credit. Moreover, the weakening of economic growth in many of the other major industrialized nations reduces the prospects for expansion in our own exports. New uncertainties about the price and availability of oil, resulting from the continuing war between Iraq and Iran, surely do not help.

We must also take account of the domestic economic legacy that President-elect Reagan will soon inherit from the Carter Administration. The news is not good, and it is perhaps worse than many of us in the private sector had anticipated. First and foremost is the problem of a budget which can only be described as hemorrhaging. Despite the great amount of talk about fiscal restraint that we have heard during the recent past, federal expenditures appear to be rapidly outpacing even the most recently raised target. What just a few months ago was advertised as a balanced budget (that for the fiscal year ending on September 30, 1981) is likely to yield a deficit larger than the $59 billion of red ink experienced in FY 1980. This is a very impressive order of magnitude that has significant impacts on financial markets, especially when off-budget financing is added to the Treasury's chores.

Secondly, the pipeline of additional, costly regulations that the federal agencies are now writing and are scheduled to be issued in the months ahead will generate additional cost-push pressures. That pipeline includes the Toxic Substances Control Act, the Resource Conservation and Recovery Act, the Clean Air Act Amendments of 1977, the Clean Water Amendments of 1977, and OSHA's new Generic Carcinogenic Standard. In addition, several other elements of cost-push inflation must be taken into account. On January 1, increases are already scheduled in social security taxes and in the statutory minimum wage.
Thirdly, the stop-and-go monetary policy that has characterized 1980 will cast its shadow on 1981. The very slow growth in the money supply between January and August -- an annual rate of three and one-half percent (as measured by M1-B) -- was, as we may now recall, followed by an almost meteoric rise in the following three months -- a yearly rate in excess of 18 percent. The next shift in the Federal Reserve System's monetary policy is likely to be on the side of restraint in the months ahead. Depending on the speed and intensity of the change, the fragile recovery may sputter or even abort.

In this context, therefore, economic policy prescriptions must be carefully crafted. Surely, large cuts in personal and corporate income taxes would be extremely helpful in providing necessary incentives for expansion of private investment, production, and employment. It is necessary to put substantial tax reduction high on the policy agenda. Then, with a lesser flow of revenues into the government, future budget planning will be more modest and restrained. That careful planning at the federal level is more likely to produce lower deficits and reduced inflationary pressures than the traditional approach. By contrast, under the present procedure, generous budget appropriations are approved and taxes are cut late in the Congressional cycle -- with the predictable result of higher deficits and more inflation.

A fundamental change would occur in government thinking under the new procedure. Rather than concentrating on what further expansions in government programs could take place, government officials would be forced to ferret out old and obsolete programs that are no longer worth maintaining under the new fiscal restraint. It is pertinent to note that President-elect Reagan already has appointed a task force of knowledgeable, former budget officials who are identifying inefficient, wasteful and other low-priority government spending activities.
Such actions could well be supplemented, in large measure, by two important policies. First, we need a program of regulatory reform designed to focus on more effective and less burdensome ways of achieving desired social goals. And second, a sensible monetary policy geared to steady growth at more modest levels than we have recently experienced is a vital part of any package of economic policy actions that are designed to promote capital and job formation -- and that are also consistent with lower rates of inflation. It is a tall order, but the need merits the effort. The response to the actual implementation of such a new program by both business and consumers is likely to be extremely positive.

A Look Toward the Future

Not all of what I anticipate in next year's economy is good news, but let me stress some optimistic notes. Over a four-year period, some key changes would be noticeable in the replacement of Jimmy Carter with Ronald Reagan in the Oval Office. Perhaps the most immediate and obvious change will simply be new faces. The extremists among the self-styled public interest groups will no longer be prominent in the appointments to the major federal commissions and agencies. There will be far more balance in the appointments process, especially toward men and women with solid, real-world experience. Clearly, these measures will have a salutary effect on public policy toward the private sector.

In an overall sense, what could a Reagan administration do? First of all, I expect that tax rates will be cut substantially; consequently, the growth in government spending -- especially in social programs -- would be slowed considerably. It may become fashionable once again for a president to veto liberal spending bills. Moreover, it is likely that more attention will be given to capital formation, and especially to the concerns of small- and
medium-size businesses under a Reagan presidency. There will be less 
regulation -- but, as in other areas, much will depend on the Congress, since 
we must keep in mind that regulation is carried out under congressional 
statute. No, I do not expect that EPA, OSHA, or EEOC will be abolished. But 
a major effort will be launched to cut back and reform wasteful and counter­
productive regulation. This is an encouraging aspect of the 1981 economic 
outlook.

Of course, we cannot ignore foreign policy. It would not surprise me if, 
early in a new administration, the Soviet Union would "test" any recently 
sworn-in Chief Executive. Thus, I expect that President Reagan will find 
himself devoting a good deal of his attention to foreign policy and 
international events. As a direct result of this, a significant expansion in 
national defense spending and military capability appears most likely. 
Certainly, much improvement needs to be made in the quality and preparedness 
of our defense forces.

In any administration, defense and foreign policy matters tend to get more 
attention than the undramatic "nitty gritty" of economic concerns. For one 
thing, the public often is more interested in personalities than in 
substantive issues. A story in the media on Ayatollah Khomeini or Billy 
Carter or whatever always provokes more citizen interest than a White House 
statement on fiscal or monetary policy. This is unfortunate, but perhaps the 
Reagan administration will bring more balance to economic matters.

We must remember that, over a four-year period, no president ever gets his 
entire initial program enacted. Whatever the party in power, that old saw 
about "...and Congress disposes" still has substantial applicability. 
Moreover, all presidents, no matter how qualified, undergo a very special form 
of "on-the-job training." A leavening process takes place in every
administration, brought about in part by the tendency for a wide variety of views to be volunteered, especially as a new president enters the White House. Nonetheless, every president tries to be his own man and to assert his independence from interest groups, especially those which are too obviously trying to reduce his freedom of action.

In general, over the next four years, a fundamental change in national outlook could begin to take place -- a shift away from an instinctive dependence on government to solve the problems facing society, and towards the private sector as the basic engine of economic growth and progress.

To those who are pessimistic about the long-run outlook for the American economy, I point to the continued inflow of foreign money. Despite the scare stories about "America for Sale," I am not worried that foreigners are buying some of our land, farms, and businesses. I recall that it was not too long ago that Western Europe was worried that American financial interests and companies were becoming too important in their economies. The French used to write about the "Coca-Cola-nization" of their country. We replied, of course, that U.S. investment was good for France. It created jobs and income in that country, and American firms also paid taxes there.

Unless we speak with forked tongue, that is the current situation here in the United States. And, in point of fact, one of the few opportunities that we have to get back the dollars we send OPEC is to have those oil-producing nations spend and invest their money here. Providing they fully abide by our laws, foreign investors have a beneficial impact; they create jobs, income, and tax collections in our country. Also, the inflow of foreign investment is a vote of confidence in the underlying strength of our political and economic institutions.
A final thought: I see no economic Valhalla in the coming four years -- but I surely do not I expect the kind of 1984 envisioned by George Orwell. The strong medicine that I described earlier -- the tax cuts, the budget restraint, the regulatory reforms, and the monetary steadiness -- can, and hopefully will, provide the basis for a sustained and less inflationary period of economic growth and prosperity in the middle 1980s. That is an exciting, though hardly guaranteed prospect.