Challenges to the US Economy: Recent Past and the Present

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The 1970s in the US economy were characterized by high levels of turbulence beginning with the fall of the Bretton Woods monetary system, as President Nixon declared the U.S. Dollar inconvertible to gold in 1971. Additionally, the Organization of Petroleum Exporting Countries (OPEC), whose member countries at the time made up two thirds of the worlds petroleum supply, placed an embargo on the United States and the Netherlands for their support of Israel in the Yom Kippur wars. As a result, from 1973 to 1974, world oil prices quadrupled. The rising gas prices and economic turmoil from the dollar's depreciation culminated in the stock market crash of 1973 and recession of 1973-1975. This was the most severe recession US economy experienced since Great Depression.

The U.S. government's policy response was to increase spending and money supply in order to boost the confidence and spending of U.S. citizens. The traditional Neo-Keynesianism dictated that expansionary polices was an answer to any economic situation especially the increased unemployment. Witness that the budget deficit when President Carter took office in 1976 was merely $30 billion. By 1980, the budget deficit had risen to $70 billion. Added to the already inflating economy, in 1979, second OPEC oil crisis sent gas prices soaring again. Additionally, the Iran hostage crisis and nation-wide strikes across the transportation industry

plagued the end of the 1970s and Carter's term as the president. Economic unrest manifested in terms of strikes of Greyhound bus drivers, steel and auto workers and to top it off, the air-traffic controllers. The economy was suffering from some severe challenges at the time of the Presidential election of 1980.

When President Reagan ran for the election in 1980, he proposed a new concept he called the "Misery Index", which he used to quantify the level of national distress. The Misery Index consisted of a sum of the inflation rate and the unemployment rate. In 1980, the Misery Index was 21 according to this formula: 13% inflation rate + 8% unemployment rate.

In October 1979, The Federal Reserve System, headed by Paul Volcker, a strong monetarist who was appointed (in July 1989) in place of Arthur Bums as the Chairman, announced that money supply growth in the United States would henceforth be limited. More specifically the monetary policy announced the resolution that the changes in money supply will be done at a short band of growth rates, irrespective of the interest rate levels. Expecting a fall in the money supply growth, the market reacted vehemently, interest rates increased, and by March 1981 the prime rates by all major banks had reached 21%. The ensuing decline in investment and GDP caused unemployment to skyrocket and ultimately, resulting into another severe recession in 1982.

The money supply data show that the Federal Reserve gave up its promise for a stable money supply growth in second quarter of 1982, as it was witnessed that from 1982 to 1988 the money supply growth increased by an 8% to 10% rate. However, the expansionary fiscal policy actions by the Reagan administration (promises of reduced governmental role notwithstanding) also increased the budget deficit by more than 300% from $70 billion in 1980

to $240 billion by 1988. Ironically while the expansionary fiscal policy was adopted, the Republican President was beating the drum with a message that lower governmental intervention his motto and objective. Additionally, each year from 1984 to 1988 saw a new record in the U.S. trade deficit. Hence the twin deficits were increasing at record breaking rates, money supply was growing from 1982 to 1988 by 8% to 10% annual rate, and the expansionary policies were visible everywhere. Nevertheless, the US economy was recovering at some unprecedented speed. The 1980s became the most prosperous decade to date. The inflation rate decreased from 13% in 1980 to 6.5% by 1988, and unemployment rate from 8% to 5.5% in the same time period. Therefore, some authors have referred to decade of 1980s as “the mysterious 1980s”. The only answer to this confusing recovery of the economy is the efficient handling of people’s expectation by the Reagan Administration. Only because Americans were not allowed to panic, the economy was recovering smoothly. Moreover the technological revolution also helped tremendously to allow economy to grow fast.

The 1990s saw even more growth, as the computer technology revolution that began in the 1980s accelerated, and compounded with the information technology revolution. GDP improved from $5.8 trillion in 1990 to $9.8 trillion in 2000, about 40% growth in 10 years. The decade of 1990 broke the record of 1980s as the most prosperous decade ever. This combination led to high expectations in the stock market, and in 1995-1998, it was not unusual for stocks to double or triple in a matter of two or three hours. Then Chairman of the Federal Reserve Board Allan Greenspan famously referred to this stock market growth as “irrational exuberance”.

The stock market success began to feed the housing market, and banks and mortgage companies started engaging in illegal and immoral activities. Balloon loans were prevalent, and fierce competition in offering mortgages resulted in unsustainably low interest rates often with zero to no money down.

In 2008 the system came to a screeching halt as the housing and stock market crashed, leading to financial crisis on a global scale. President Bush initiated the TARP, or tax assisted recovery program, which was essentially a one-time $750 billion bailout by Congress. This expenditure represented almost one third of the 2008 government expenditure, which totaled $2,400 billion. With tax revenue totaling only $1,920 billion, this left the United States with a budget deficit of $480 billion in 2008, twice the deficit in 1988 and almost seven times that in 1980.

When President Obama took office in March of 2009, he issued another $750 billion stimulus package. Tax revenue for 2009 was $2,200 billion, while government expenditure reached $3,800 billion. Thus the 2009 government deficit reached to a shocking and record breaking figure of $1.6 trillion. In order to fund such enormous budget deficit, the United States government has borrowed more and more and it has gone further into national debt. The U.S. national debt by the first quarter of 2013 has reached to $16 trillion, and it is further increasing on average by $1 trillion each year. Typically, the debt to GDP ratio is an indicator of a country's credit rating. History has shown that when the ratio reaches 120%, bond ratings begin to fall. The U.S. debt to GDP ratio is currently about 100%, as the national debt and GDP are each about $16 trillion.

However, the U.S. arguably has some flexibility in this area for a few reasons. First, the majority of U.S. debt (around 75%) is internal, meaning the government owes this money to its own population. As budget debt is financed by selling treasury bonds, or securities, majority of this debt is owed to the American people, not other nations, and thus is less indicative of financial crisis. Hence the internal debt is much more manageable than the external debt. Second, the United States, country as a whole, is exceptionally innovative, enterprising, hard working, and very competitive. This American spirit originates from private sector's untiring enthusiasm in the U.S. economy, government actions of all kinds notwithstanding. There is no way to know what the next "big thing" will be, just as there was no way to predict the computer or information revolutions, but the American people have a great capacity for innovation that will aid in maintaining the U.S. economic lead and stability. In 1960s the manufacturing sector took the initiative, while in 1980s and 1990s the technology sector led the growth. So for an optimist, there is always a guarantee that some new sector will pop up to drive the future growth in USA. Lastly, The Unites States remains the global hegemon, militarily strongest nation on earth, and the advantages of this are stabilizing, not destabilizing to its economy.

Nevertheless, from the policy perspective, serious cutbacks in the total expenditure growth of the United States government are essential to the future stability of the nation. These cutbacks will have to undoubtedly occur before it is too late, and the debt to GDP ratio becomes too high. But the real question is when can we see the danger signs? As with most important but unpleasant things, the rising budget deficit will likely be curbed at the last possible moment. The American population, though not in favor of the high deficit, is often

unwilling to see funding go from favored sectors of the economy, and lobbying and unionization make these cutbacks a difficult task.