SFChronicle MAY 22 1973

Why U.S. Economy Is Troubled

By Hobart Rowen
Washington Post Service

Washington

The stock market slumped again in New York yesterday, and gold prices soared to spectacular new highs in Europe as traders and investors continue to show fear about the future of the American economy.

In particular, the uncertainties generated by the Watergate scandal and wide discussion of the possibility that President Nixon may not be able to stay in office, have added anxiety.

Yesterday, a specific rumor that presidential adviser Henry Kissinger had resigned worsened a case of the jitters that in the past ten days has pushed gold prices over the $100 mark. Gold closed in London at $112 an ounce, $7.50 above Friday's close — a level that approaches three times the "official" price of $42.22.

According to congressmen present at a closed House banking subcommittee session yesterday, Treasury Undersecretary Paul Volcker attributed the gold price increase to an unstable picture created by the Watergate affair, and to inflation in the U.S.

Volcker, and Federal Reserve chairman Arthur Burns were reported to have said that the dollar is "basically sound" and to have assured the committee there is no U.S. plan to devalue the dollar again.

CONCERN

But the Watergate and its enveloping web are merely the surface symbol of a more basic concern of financiers about the economy.

Simply put it is: Will the current level of prosperity, now at a peak with high profits, sales, and employment levels, degenerate into a recession?

Many economists and analysts think that it will, largely because the boom — with its attendant price inflation — will run out of control, resulting in a traditional bust.

Most who think this way time the recession for late in 1973 or early 1974.

But the Nixon administration's economists do not agree.

Herbert Stein, chairman of the Council of Economic

See Back Page

From Page 1

Advisers, said yesterday that "recession is not a probable outcome", and that the stock market reaction is "wild and panicky, and not justified by the real prospects of the economy."

The National Bureau of Economic research of New York, which is accepted as an independent, academic authority on the business cycle, takes a different view.

Bureau member Geoffrey Moore says that there is clear evidence of a forthcoming "slowdown" in the economy which could become an actual recession, meaning a decline in real growth rates for a period of at least six months.

CAPACITY

Moore bases his judgment on a sophisticated assessment of a highly technical scorecard of economic indicators which, in effect, show the economy pushing so close to a capacity level that it can go no higher and must start a slowdown process.

Stein, in fact, agrees with Moore that a slowdown is inevitable, but Stein argues that there is nothing in the picture — except fear — to suggest that the slowdown will be anything more than a healthy retreat from the "overheated" growth rate of 8 per cent in the first quarter of 1973.

Many economists trace the current troubles of the economy to the over-hasty relaxation of price controls on January 11, which was followed very quickly by the second devaluation of the dollar in 14 months.

WAVE

The net result was the unleashing of a wave of inflation in industrial and raw materials prices, coincident with an explosion in food prices.

"Just when the economy should have been slowing to a trot," says Democratic economist Arthur M. Okun, "it began to spring and has maintained a breathless pace so far in 1973. Suddenly, the consumer became a tremendously enthusiastic spender. More recently, plant and equipment has jumped on the bandwagon and inventories are bound to join."

Thus, in the three months of Phase Three from January to April, all wholesale commodity prices jumped 21.2 per cent, compared with 6.9 per cent in the 14 months of the more tightly controlled Phase Two. Consumer finished goods, in the same comparable periods, went up 12.8 per cent, compared to 2.3 per cent.

The reaction to this trend in Wall Street was a collapse in stock market prices (from 1029 on the Dow Jones industrials index before Phase Three was announced, to below 836.51 at yesterdays close and the spectacular rise in gold (from $65 in January to $112 yesterday) as speculators and businessmen tried to develop a hedge against the dollar.

FLOATING

The gold market, of course, also has mirrored the uncertainty in international monetary markets since a crisis in March closed the official exchanges, later resulting in an agreement under which the dollar and all other major paper money are "floating" — that is, moving according to market demand, rather than being fixed in terms of gold or anything else.

The amount of actual trading in the gold markets is skimpy and almost any sort of rumor is sufficient to drive the price sky-high. Thus, a May 8 statement by presidential assistant Peter M. Flanigan (later denied by the Treasury) that growing U.S. needs for foreign oil might force yet another dollar devaluation was sufficient to send the gold price soaring.

The Commerce Department's report last week that the U.S. balance of payments deficit had zoomed to $10.1 billion in the first quarter didn't help matters either.

POLICY

The dispute over the possibility of a recession has resulted in a division of opinion over the proper economic policy to pursue at this juncture.

Stein said yesterday that "we don't see a slowdown below the 4 to 4¼ per cent real growth rate" that all economists agree would be ideal. Given that forecast, Stein and his associates believe that the present policy mix of a restrictive monetary and fiscal policy should not be changed.

Okun, in public comments recently, has suggested a further tightening in monetary policy and a strengthening of the wage-price administration. Pierre Rinfret, a New York business economist and former Nixon adviser during the election, has in addition urged a 15 per cent income surtax, to be put in escrow against the time that the economy would need a lift.

RISK

The Administration thinks that a more austere policy now would run the risk of creating higher unemployment.

It argues, in essence, that much of the anxiety in the markets is self-generated. "The financial community is suffering from an unrealistic view of the problems and prospects of the American economy," Stein told a meeting of the Society of American Business Writers in New York ten days ago. "The realistic outlook for the American economy is that profits are big and rising, and will continue to rise, and that the future doesn't indicate a bust."

He added yesterday that "even the people who take a rather pessimistic view aren't forecasting anything very bad." In a telephone interview, the Economic Research Bureau's Moore agreed with that perspective. "If we do have a recession," he said, "It likely would be a mild one."

But the jitters are likely to continue so long as Watergate clouds the prospects for Mr. Nixon and his Administration.