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# UNDERSTANDING THE NEW ECONOMY

***Alfred L. Malabre, Jr.***

author of *Beyond Our Means*, Winner of the 1988 Eccles Prize.

# Understanding the New Economy

**Alfred L. Malabre, Jr.**

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*Rededicated to  
Mary Patricia, with gratitude for your  
support and patience*

## **OTHER BOOKS BY MR. MALABRE**

**America's Dilemma: Jobs vs. Prices**  
**Investing For Profit In The Eighties**  
**Beyond Our Means**

## NOTE TO READERS

Back in 1975 I wrote a book entitled *Understanding the Economy: For People Who Can't Stand Economics*. It sold well. A lot of people either wanted to understand the economy or couldn't stand economics—I don't know which. This book is a direct descendant of that earlier work.

Many aspects of economic life have changed in the intervening 13 years. Much is truly "new," and I've tried to reflect that in the pages that follow. So much has changed that this is, in large part, a new book, not a revision. If you read the old book, we both know, for starters, that you're a lot older now. I hope that you'll enjoy reading this one.

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# CONTENTS

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<b>CHAPTER 1</b>	
Some Words of Explanation	<i>1</i>
<b>CHAPTER 2</b>	
Into the 1990s	<i>6</i>
<b>CHAPTER 3</b>	
The Headline Grabbers	<i>11</i>
<b>CHAPTER 4</b>	
Subtler Signs	<i>31</i>
<b>CHAPTER 5</b>	
Ups and Downs	<i>52</i>
<b>CHAPTER 6</b>	
Changes, for Better and Worse	<i>74</i>
<b>CHAPTER 7</b>	
Do-It-Yourself Forecasting	<i>96</i>
<b>CHAPTER 8</b>	
True and False Prophets	<i>132</i>
<b>CHAPTER 9</b>	
The Global Connection	<i>146</i>
<b>CHAPTER 10</b>	
The Economy You Can't See	<i>158</i>

# CHAPTER 1

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## SOME WORDS OF EXPLANATION

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This book is for the person who wishes to keep reasonably well-informed about economic developments. It is for the interested layman who wants to gain a little perspective on the economic headlines that come at us daily from television, radio, and the newspapers. It is for the concerned *nonexpert* who seeks not expertise but enough familiarity with economic data to allow an intelligent personal appraisal of where the economy stands and where it may move in future weeks and months.

This is *not* a book for anyone wishing to study the social science of economics. It is *not* a book espousing any particular economic theory. It is *not* a book for anyone who is content merely to accept what others, in high or low positions, may be saying about the economy.

Most decidedly, this is *not* a textbook. Most decidedly, it urges no political point of view. The only converts it seeks are converts to a more enlightened assimilation of daily economic headlines.

Within these pages, you will find not a single formula or chart or graph. Nor will you encounter at the end any glossary of economic definitions. When you come to a term that requires defining, it will be defined on the spot.

At the end you will find an index. If you want to discover quickly what the gross national product is really all about, you can look it up in the index and then flip to the appropriate pages. You will obtain, I submit, a more useful description of what the GNP actually represents than could be provided by the standard glossary-type definition that appears in textbooks.



Just as this is by no stretch of the imagination an economics textbook, I am by no stretch of the imagination a professional economist. I am a newspaperman, employed by *The Wall Street Journal*. I happen to find considerable fascination in observing and writing about the American economy. But I would be hard-pressed to explain to you the difference between a regression series and a diffusion index. And I question whether you would care to have me explain. It would be a boring business.

There is nothing boring, however, about trying to understand some basic things about the nation's economy—what goes into it, what comes out of it, how we measure it, how it moves and changes, how it is influenced by the behavior of businessmen and the decisions, for better or for worse, of government officials and political leaders.

A fundamental premise of this book is that many Americans share an interest in such matters. But another premise is that an unfortunate combination of circumstances works to discourage people from becoming better informed about the economy. Almost without exception, the few good economic textbooks available are fat and forbidding, and they generally fail to provide such elementary information as where to find and how to read basic understandable gauges of the state of the country's economy.

The unhappy result is a dearth of fundamental material for the individual—student or interested layman—who merely wants to be able to regard the economic scene with a little common sense and sophistication.

"Economics as a science is not 'dismal'—as Thomas Carlyle once called it," says Charles E. Walker, a professional economist who served as a high official in the Treasury Department from 1969 to 1973. "The problem is that it has been dismally taught—if taught at all."

Speaking of the need for a greater understanding of the economy by the electorate, Mr. Walker remarks: "It is not a job that will be over soon, but we must get on with it or wake up some day to find ourselves with an economic system that nobody wants—one that performs poorly and fails to deliver in a manner that the people of the U.S. have come to expect. If our eco-

conomic system does fail, the underpinnings of our participatory democracy will indeed be weakened and the chances of fulfilling the American dream will be greatly reduced."

Tilford Gaines, senior vice-president and economist of Manufacturers Hanover Trust Company, a large New York bank, once wrote: "It is amazing how ignorant most Americans are about the free-enterprise economic system and, particularly at the present moment, how little faith there is in its continued functioning. All educated people understand our political system and the checks and balances that have enabled it to work. All religious people understand the tenets of their faith. Each artisan or professional understands the rules of his trade. But how many understand the logical structures of our economy and importance of our economic institutions within our total social fabric?"

A survey has found that only about half of the nation's 60,000 social-studies teachers—those most likely to be teaching economics courses in schools—have had any formal training in economics. Another finding of the survey was that only about a quarter of the nation's junior-high-school students understand the difference between a free-enterprise economy and one that is completely government controlled.

What percentage of those students would be able to identify the Federal Open Market Committee and the fundamental role that committee plays in shaping America's economic future? My guess would be, at the most, a minuscule fraction of the 25 percent who managed to identify free enterprise.

As Charls Walker suggests, the way in which basic economics is generally taught may be to blame for much of the aversion to economic matters. Too frequently, introductory courses that should simply equip students with basic tools for understanding economic developments focus instead on boring, impractical theoretical matters. That may be fine for anyone moving on with economics as the major course of study. But it is of no discernible use to the student who merely wants to be able to digest the abundant economic news and perhaps make a few intelligent judgments.

A case in point is my own classroom experience with eco-

nomics at Yale University shortly after World War II. Unfortunately, the classroom scene has not changed appreciably since then. The course at Yale, Econ 10, was a half-year affair, supposedly a simple introduction designed for students majoring in other fields. (Mine happened to be English.) The course consisted mainly of discussing assorted formulas and curves, drawn majestically on the classroom blackboard by the instructor. It was uninteresting in all respects; it had, so far as I could determine, not the faintest connection with the real world beyond the New Haven campus.

Benumbed and benighted, I managed—barely—to pass the course. But it remains to this day the one and only economics course that I have ever suffered through.

The economy can probably never be made as interesting as a good Alfred Hitchcock thriller. However, there is no need for it to be made dismally dull. The economy can be an intensely interesting subject—to nonexperts as well as professional economists. Moreover, it can be followed, by those willing to try, without any real difficulty. To follow it requires no in-depth scholarly comprehension of the intricate workings of the economy. But it does require common sense and a passing familiarity with what has happened in the past. No more expertise is needed than in understanding the more rudimentary baseball statistics (nothing so complicated as slugging percentages) and knowing the difference between two percent and two percentage points.

Parenthetically: you may discover, as a dividend to a better understanding of the economy, that you will be able to invest your money more wisely. Certainly, my own economy-watching over the years has enabled me to venture out occasionally with my crystal ball. I do recall, for example, a column of mine that appeared December 8, 1969—a gloomy time on Wall Street. The widely watched Dow Jones industrial-stock average stood at 785.04, down sharply from about 970 in mid-May of 1969. The economy clearly seemed headed into a recession. Unemployment was moving steadily upward. Corporate profits were sliding in the opposite direction. It hardly seemed an appropriate moment for a cheery, lighthearted appraisal of stock-market prospects. Yet, that was precisely what I produced for the *Journal's* readers that Monday morning.

"What the stock market needs," I cheerily started out, "is a good recession; there's nothing like a business slump to perk up stock prices." The column went on to suggest, on the basis of various statistics, that a recession indeed appeared imminent and that, consequently, most stock prices appeared quite reasonable. The column went so far as to forecast that stock prices, though due for a "sustained . . . rebound" from the December 1969 level, would probably flounder around for several months before beginning a big climb.

The record book shows that a recession did begin about that time—the National Bureau of Economic Research, official arbiter in such matters, places the start in November 1969. The record further shows that stock prices, measured by the Dow Jones average, did flounder around until May of 1970 and then began a sustained rise, gradual at first, that brought the average to 840 by the end of 1970 and to more than 950 early the next year. Thus, my 1969 column, had its advice been taken, would have enabled an investor to pick up some 165 points on the Dow Jones index in less than 18 months.

No training in economics or finance was responsible for the accuracy of that forecast. Rather, a little common sense research into business history was all that was necessary—research that anyone with an ability to read the English language and a mild tolerance for a few uncomplicated statistics could have undertaken. Even a cursory glance at the appropriate figures shows that stock prices often are higher at the pit of a business recession than around the peak of a preceding expansion period. In many instances, the rise in stock prices during a recession has been dramatic.

Nicholas Von Hoffman, an exceedingly able and articulate syndicated newspaper columnist, once observed that "time was when nobody but economists and upper-echelon people in big business paid attention to economic statistics," but now "the media throw more and more of those numbers at us."

This book will enable you to understand a lot more about what is coming at you the next time an announcer or a politician or a newspaper reporter starts spouting economic statistics. A particular figure on a particular day may be important, or it may not be. In any event—most importantly—you will be able to make that judgment for yourself.

## CHAPTER 2

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### INTO THE 1990s

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As we head into the 1990s and, beyond them, toward a new century, the matter of trying to understand, in fundamental terms, what America's economy is really all about assumes a fresh importance. Much has changed on the economic front since I wrote an earlier version of this book in 1975. In the intervening years, the economy has expanded sharply and endured severe downturns, the stock market has set new highs and taken record-shattering tumbles, and America's role on the world stage has diminished with the startling rise not only of Japan but of such formerly undeveloped nations as South Korea and Taiwan.

On a planet shrunken by new technology—for instance, in the areas of transportation and communications—it grows ever more apparent that swift change and global competition are the order of the day. It becomes imperative, in such an environment, to appreciate how our economy works, its underpinnings. If the stock market crashes, how does that relate to what economists call the business cycle? If overall economic activity expands strongly, how is that likely to affect the consumer price level?

With the many difficulties that have beset our economy in the more recent decades of the post-World War II era, it has become an easy matter, even fashionable, to take a cynical view of trying to make sense out of the economic scene, or out of what economists themselves are saying. The list of jokes about the profession, all unflattering, expands apace. For instance: Sound advice for economic forecasters is, If you give a number, don't give a date, or if you give a date, don't give a number, and if you're determined to keep forecasting, do it frequently. Or: Economists show that they have a sense of humor by their use of

decimal points in their projections. Or: The length of an economic research report is inversely proportional to how well the economists producing it know what they're doing. Or: The more closely you look at the raw data in any economic analysis, the bigger trouble you're in. Or: An economist is someone who is good with numbers, like an accountant, but lacks the personality to be an accountant.

The list goes on, and grows even less charitable. And, though it clearly smacks of high hyperbole, it does reflect a deepening dismay over a seeming inability among the people expected to do so to assess the nation's economic performance in convincing fashion and provide sound advice for policy makers.

Indeed, there has developed a widespread sense that, in economic policy-making at least, we have entered a sort of Euripidean era, to recall a dismal progression in ancient Greek playwriting. In the plays of Aeschylus, in the early period, the particular tragic hero inevitably suffers but learns from this and emerges a better person, blessed with a new, heightened awareness. In the plays of Sophocles, in the middle Greek phase, the hero once again suffers but learns little from this. However, some benefit is derived because others, such as the audience, do gain valuable insight. In Euripides, in the final phase, the suffering continues, but it is pointless, with no discernible good coming out of it. All is senseless and cynicism prevails.

Something like this disheartening transformation has occurred over the last several decades on the economic front. In the early postwar years, there was a general sense among government and business leaders in the United States that, while America's economy was hardly immune to trouble, it could be made to expand smoothly and continuously with the proper mix of fiscal policies. Indeed, in the middle 1960s, during Lyndon Johnson's presidency, something akin to what the Greeks called *hubris*—overweening pride—set in in policy-making circles, so that eminent economists, who should have known better, became convinced that a sort of perpetual prosperity was in prospect. What the future held instead, it developed, was what the Greek playwrights deemed the ultimate stage in the tragic progression, inevitably following on the heels of *hubris*. They called it *ate*—devastation, despair, defeat. Or, in terms of the postwar

American economy, spiraling inflation, wrenching downswings in economic activity, periodic double-digit jobless levels reminiscent of the 1930s, and Brobdingnagian deficits in both the federal budget and foreign trade.

With such difficulties, it is no surprise that a sort of Euripidean cynicism tended to take hold. Reenforcing the disillusionment has been the inability of successive schools of economic thought to set things right. In the Johnson presidency, the assumption was that economic prosperity could be assured, in the main, through adroit manipulation of taxes and federal spending, a prescription based largely on the writings of John Maynard Keynes, the British economist. Relatively little heed was paid to monetary policy, what was happening to the nation's supply of money, under regulation by the Federal Reserve Board. A decade or so—and a severe recession—later, during Jimmy Carter's White House tenure, there was a shift to the so-called monetarist approach to economic management, which tied the growth of the money supply to the economy's own estimated capacity to expand. The hope, once again unfounded, was that monetarism would lead to uninterrupted economic gains, turning slumps, inflation, and the like into nothing more than distant, unpleasant memories. The chief advocate of this shift to monetarism was a Nobel-laureate economist from the University of Chicago. Milton Friedman, of whom we shall hear more later.

After monetarism came the so-called supply-side economists, led by Arthur Laffer, a fast-talking, publicity-loving California-based professor who managed to convince Ronald Reagan, among others, that the path to sustained prosperity was through neither Keynes nor Friedman but something he called the Laffer curve, a parabola which he first transcribed for an inquiring journalist on a cocktail napkin in a Washington, D.C., bar. The essence of the supply-side notion was that tax rates were far too high, discouraging productivity and saving. Moreover, the Laffer school held that rate reductions would unleash such a burst of economic activity that the federal budget balance would actually tend to strengthen, rather than sink ever more deeply into the red on account of diminished tax revenues.



Of course, the budget did sink into much deeper deficit after the supply-side tax cuts were enacted early in the Reagan presidency. At the same time, productivity continued to stagnate in most businesses, and savings, in terms of income, reached the lowest readings since the Great Depression.

The inability of any particular school of economic thought to produce a recession-proof, inflation-proof strategy should not be taken as a reason to despair of trying to gain a fuller understanding of how our economy works. Indeed, the failure in recent decades of so many different policy-making schools to produce the desired economic results is all the more reason for us to try to see where the difficulties may lie, to try to understand the economy's limits, as well as its potential. If for no other reason—and there are many—such an understanding is crucial when political office seekers proclaim from the soapbox, as they are wont to do, their wonder-prescriptions for economic salvation.

You will find no such remedies on these pages. But neither will you come away sensing that nothing can work, that any serious effort to achieve a sounder economic performance inevitably must fail. On the contrary, we will see that our economy has made great strides in the postwar decades and is surely capable of much further progress—but this inescapably will entail difficulty, for that is how the economy advances, never in a straight, uninterrupted line up, never without the occasional slump, never enjoying the sort of recessionless prosperity advertised by the ever squabbling proponents of this or that or the other school of economic thought.

If there is a judgment to be made here, it is that the economy can indeed be managed, made to work, but not through any quick fixes, not through simply pushing the right monetarist or fiscalist or supply-side button. As a wise physician once told me, everything should be done in moderation, and that applies as well to economic policy-making as to health. And, in a nation as free as ours, where so much depends on enlightenment at the ballot box, it becomes extra crucial that this be understood. If this book generates a healthy skepticism about economic panaceas, that is fine. It should not, however, lead anyone to cynicism.



A skeptical, realistic—but never cynical or despairing—assessment of the American business scene as the century winds down suggests, ultimately, that our economy is both “new” and “old.” It is new in the sense that we have learned most painfully in recent decades that prosperity no longer will come as easily as, say, in the early postwar years, when much of the developed world, but not America, was disrupted by global conflict. And the economy is old in the sense that the same fundamentals and intertwined relationships that pertained 30 or 40 years ago, as well as earlier, continue to do so—to cite an illustration, within the framework of the business cycle, the roles played by money growth and spending, by profits and prices, by productivity and saving.

Precisely because the going has recently grown tougher, these basics demand far closer scrutiny and better understanding now than decades ago, when times, at least on the economic front, seemed easier and simpler. If we are able to appreciate, for instance, exactly how the Federal Reserve Board undertakes to regulate the growth of money and the level of interest rates, if we can grasp what the term “money” actually encompasses, then we are better able to render a sound judgment the next time a campaigning politician calls for the Fed, say, to bring down interest rates posthaste or to open a monetary spigot that may already be open wide.

It is only possible, in sum, to understand the new economy by understanding the old one. They are the same. The fundamentals that applied yesterday continue to apply today and also will do so tomorrow.