

Two (Pleasant) ECONOMIC SURPRISES

The U.S. economy looked very different at the start of the 1980s than at the end of the 1990s. Two favorable changes made all the difference in the world...

Surprise #1: Strong Economic Growth with Very Little Inflation

On New Year's Day 1983, even eternal optimists must have wondered if the U.S. economy would ever regain its balance. The preceding ten years had seen an unsettling string of economic ups and downs. And all too often, things that should have been up were down (GDP growth), while things that should have been down were up (inflation). Here's a summary:

1974: Stagflation I: GDP contracts by 0.6 percent and the Consumer Price Index climbs 12.3 percent.

1979: Stagflation II: Another round of faltering GDP growth and escalating prices. GDP is up just 0.3 percent in the second quarter, while consumer prices surge 13.3 percent for the year. In October 1979, the Federal Reserve moves to curtail double-digit inflation by implementing an extremely restrictive monetary policy. Interest rates soar, and the economy stalls.

1980: The economy is in recession. The Fed responds by easing monetary policy, and by midyear the recession ends.

1981: Renewed concern over inflation prompts the Fed to tighten monetary policy again. Rates soar past their 1980 levels. The prime rate tops 20 percent, home mortgage rates hit 18 percent, and 22 percent car loan rates prevent a lot of dri-

vers from enjoying the smell of a new car.

1982: The economy sinks back into recession; by yearend the unemployment rate has shot up to 10.8 percent.

As 1983 approached, there was one economic bright spot: Inflation seemed to be moderating; the CPI rose just 3.8 percent for the year.

But inflation had seemed to moderate more than once during the 1970s and early 1980s. Would there be another inflationary spike in 1983 or 1984? The uncertainty of the preceding ten years had made Americans extremely wary. Many were beginning to wonder if the U.S. economy's best days were all in the past.

Then, during the mid-1980s, the economy made a comeback that would surprise nearly everyone with its strength and staying power. The turnaround was so complete that there was talk of a "new paradigm" in which high growth and low inflation would be the norm. (See table, "The Halcyon Late 1990s.")

So, what does this all mean for the future? Has there been a fundamental economic change? Can we look forward to continued strong growth, modest inflation, and low unemployment?

Perhaps the best answer to these questions is a quote often attributed to economist John Kenneth Galbraith: "Economists make predictions, not because they know, but because they are asked." Let's just leave it at that.

Surprise #2: The Federal Government Ran a Surplus

Between 1980 and 1985, the federal debt doubled. Why? The short answer is "too much money going out and not enough coming in." A sharp economic downturn and a substantial federal tax cut combined to reduce revenues; a sizable defense buildup left little leeway for federal spending cuts.

Everyone, from editorial writers to park bench philosophers

worried that the government's fiscal woes were spiraling out of control. Whenever two people got together, one of them was bound to say, "If I ran my business (or household) like that, I'd be bankrupt."

And by 1995 — despite all the talk, the concern, and even some concrete political action — things were no better. Total federal debt approached \$5 trillion, and the ratio of federal debt to GDP stood at 67.2 percent — more than double what it was in 1980. (See table on federal debt.)

Then, just when the problem seemed to defy all solutions, the tide of red ink began to subside. The federal government ran budget surpluses in three consecutive years: 1998, 1999, and 2000. And although federal debt totaled nearly \$5.7 trillion at the end of 2000, federal debt as a percent of GDP had dropped to 57.3 percent from a mid-decade high of 67.2 percent.

A combination of factors was responsible for the turnaround:

(1) Strong economic growth and a soaring stock market boosted federal tax revenue during the late 1990s and reduced the need for federal spending on economic relief programs.

(2) The federal government maintained a commitment to fiscal restraint.

It was a scenario few would have dared to write in 1985 — or even 1995.

Want to Know More?

For more information on the federal budget, visit the Office of Management and Budget web site and check out *A Citizen's Guide to the Federal Budget*. <http://www.whitehouse.gov/omb/budget/>

Looking for GDP data? Visit the Bureau of Economic Affairs web site. BEA is an agency of the U.S. Depart-

The Halcyon Late 1990s

U.S. GDP Percent change based on chained 1996 dollars	U.S. CPI Percent change from previous year	UNEMPLOYMENT RATE Percent
1995: 2.7	1995: 2.5	1995: 5.6
1996: 3.6	1996: 3.3	1996: 5.4
1997: 4.4	1997: 1.7	1997: 4.9
1998: 4.3	1998: 1.6	1998: 4.5
1999: 4.1	1999: 2.7	1999: 4.2
2000: 4.1	2000: 3.4	2000: 4.0

Source for GDP data: U.S. Bureau of Economic Analysis, U.S. Department of Commerce.
Source for CPI and unemployment data: U.S. Bureau of Labor Statistics.

THE SWITCH FROM GNP TO GDP

In 1991, the Bureau of Economic Analysis began using gross domestic product (GDP) to measure the size of the U.S. economy. From 1941 to 1991, it had used gross national product (GNP). Here's the difference.

GDP measures the market value of final goods and services produced within a country's borders during a given year. Example: A new car produced by a Japanese-owned company at a factory in Kentucky would be included in the U.S. GDP figures; a new car produced by an American-owned company at a factory in Brazil would not.

GNP measures the market value of final goods and services produced by U.S. residents anywhere in the world, and it includes the income earned on foreign investments made by U.S. citizens and American-owned companies.

For a comprehensive and highly readable discussion of GDP — how it's calculated and what it means — visit the National Council on Economic Education web site.

<http://www.econedlink.org/lessons/index.cfm?lesson=EM170>

Federal Debt (1980 to 2000)

	TOTAL FEDERAL DEBT	AS PERCENT OF GDP
1980:	\$909 billion	33.3
1985:	\$1.81 trillion	43.9
1990:	\$3.21 trillion	55.9
1995:	\$4.92 trillion	67.2
2000:	\$5.63 trillion	57.3

Source: U.S. Census Bureau, *Statistical Abstract of the United States: 2001*.

ment of Commerce. <http://www.bea.doc.gov>

Ever wonder how the CPI is calculated or what goods and services it covers? The answers to these and 20 other related questions are on the Bureau of Labor Statistics web site. <http://www.bls.gov/cpi/cpifaq.htm>

Another useful BLS resource is *Monthly Labor Review*, which features articles on a wide variety of labor force issues: employment, inflation, productivity, and occupational injuries. <http://www.bls.gov/opub/mlr/mlrhome.htm>

For a year-by-year look at monetary policy and inflation during the 1980s, read "Consumer Prices in the 1980s: The Cooling of Inflation." <http://www.bls.gov/opub/mlr/1990/08/artfull.pdf>

"Time Well Spent," the featured essay in the *1997 Annual Report* of the Federal Reserve Bank of Dallas, looks at the declining *real* cost of living in America. <http://www.dallasfed.org/htm/pubs/annual/arpt97.html>