



The Chinese written language is composed of characters which represent ideas. The compound ideograph depicted here represents the concept of crisis. The top half of the crisis character stands for danger while the bottom half represents opportunity. Crisis, consisting of both danger and opportunity, appropriately describes the U.S. economy today.

The structural, long-term problems facing the economy are very serious and well-known. They include: excessive debt; the depression in commercial real estate; massive loan losses at thrifts, banks, and insurance companies; low productivity, savings, and profit margins; and an accumulation of inadequate investments over many years. While many of these problems will have an impact on the shorter-term outlook for the economy, their greatest impact will be on future living standards for the vast majority of U.S. citizens.

We have no intention of minimizing these problems, but at times like this we should not forget the “opportunity” aspect of the “crisis” character. In a cyclical sense, the economy will recover. It may not recover on time or be as strong as we would like, but the odds favor a recovery given the aggressive easing by the Federal Reserve Board. Once the recovery does occur, profits are likely to be surprisingly strong in many segments of the economy. Those sectors of the economy which have restructured and downsized are likely to experience surprisingly strong profit growth.

In the short-term, cyclical “opportunity” is important but we should not lose sight of the longer-term or secular “opportunity.” A point to be emphasized as a longer-term positive is the likelihood of low inflation and lower interest rates (cost of capital) in the future.

The credit binge of the 1980’s left the economy with a glut of just about everything for which debt is used to build—office buildings, hotels, theme parks, and resort condominiums, to name a few—and which will take years to absorb. That credit binge also left us with a debt-laden consumer. Efforts are now being made by these parties to reduce debt. Borrowing will be subdued in the future as consumers are leery about borrowing and businesses are limiting their expenditures to those projects which offer viable return potential. The positive in low debt growth is low inflation and a lower cost of capital which improves our competitive position relative to other industrial nations.

Another very important positive for the future stems from the decline of communism. The spectacular failure of communism in the Soviet Union brings into much sharper focus the extraordinary success of capitalism in the West. The communist system of central planning destroyed economic incentives. It wasted economic resources and polluted the environment beyond comprehension.

As a counterexample, the Soviet experiment demonstrates the benefits of free trade. Being closed off from engaging in free trade with the West is a major reason the Soviets fell behind to the point that their country could no longer support its burdensome military budget.

We now have the former Soviet Empire moving toward free trade. The European Community starts its free trade zone this year. And, hopefully, the entire North American continent will be a free-trade zone by the middle of the decade with South America to follow.

It has been demonstrated that free trade is vital to economic growth. The encouraging thing is that, contrary to what Lee Iacocca would have us believe, much of the world is moving in that direction which should improve the situation for all. It is this factor which greatly reduces the odds of another 1930’s when a recession was turned into a depression with the passage of the Smoot-Hawley Tariff in June, 1930.

Each evening as we read the newspaper and watch the news we are told of the crisis facing our economy. In these difficult times it is important to remember that while crisis is typically associated with danger, it represents opportunity as well.

Year End 1991