

Fall 1978

The Economics of the Carter Administration

Hyman P. Minsky Ph.D.

Follow this and additional works at: https://digitalcommons.bard.edu/hm_archive

 Part of the [Macroeconomics Commons](#)

Recommended Citation

Minsky, Hyman P. Ph.D., "The Economics of the Carter Administration" (1978). *Hyman P. Minsky Archive*. 55.

https://digitalcommons.bard.edu/hm_archive/55

This Open Access is brought to you for free and open access by the Levy Economics Institute of Bard College at Bard Digital Commons. It has been accepted for inclusion in Hyman P. Minsky Archive by an authorized administrator of Bard Digital Commons. For more information, please contact digitalcommons@bard.edu.

Fall 1978, vol. 1, Issue 1

One comes with even greater embarrassment to an additional and equally glaring difference between the 1960s and the 1970s. Under the impact of OPEC, dollar devaluation, perverse agricultural subsidies, revived protectionism, and Washington inaction, inflation is much higher than the figure which in 1969 seemed threatening enough to cause President Nixon to preside over a small recession and by 1971 menacing enough to Republican electoral prospects to justify the spectacular putsch of August 15, 1971 — wage-price freeze, 10 percent import surcharge, and the rest of the New Economic Policy. Under this threat, it would seem almost platitudinous for any administration to accompany stimulus with at the least firm guidelines and preferably with stronger institutional restraints, either selective controls over key price and wage decisions or some variation of Weintraub-Wallich-Okun manipulation of rewards and penalties for responsible or irresponsible price and wage behavior. As I write in mid-April, the White House has done worse than abdicate from anti-inflationary action. It has in fact been pursuing a pro-inflationary course by such responses to pressure as additional farm subsidies and trigger prices to protect our notoriously unprogressive steel industry.

As matters now stand, there is a distinct probability that a new recession in fairly short order will follow the sluggish and unsatisfactory recovery of 1975-78. Starting from 6 percent unemployment, it may well bring us 10 percent general unemployment and, with the usual malign multipliers at work, 20 percent black unemployment and figures for teenagers that squeamish, middle-aged souls like me hesitate even to mention.

What hope? As Dr. Johnson said, nothing so concentrates a man's mind as the prospect of imminent execution. For politicians the next election is a suitable semantic equivalent. Just as in 1971 a frightened Nixon suddenly jettisoned his anticontrol prejudices, so by the time this screed is in print may Jimmy Carter have reached the conclusion that his hope of reelection or even renomination will be dim unless he learns to cope better with the disorders of the American economy. Nothing would gratify me more than the negation by intervening events of most of what I have here said.

HYMAN P. MINSKY

iatrogenic (adj.) Induced in a patient by a physician's words or actions.
The American Heritage Dictionary of the English Language

In the case at hand, the patient is the United States economy, the physicians

The author is Professor of Economics at Washington University in St. Louis.

are economists who advise and serve the Carter administration, and the "words and actions" are determined by economic theory. The neoclassical synthesis is the economic theory of the economists who advise and serve our administration, regardless of whether the administration is Democratic or Republican. However, as Mr. Carter and his Georgian phalanx have no independent knowledge of economics and no prior exposure to national and international economic problems, they — to a greater degree than was true of prior administrations — are prisoners of their advisors. The problems as defined for the administration and the policy options which are considered reflect the tunnel vision imposed by the neoclassical synthesis.

The failures of the economy and of policy in the last decade should force economists to consider whether the definition of problems, the analysis and prescriptions put forth by the policy-advising establishment, are responsible, at least in part, for what is wrong. The appearance of the *Journal of Post Keynesian Economics* is evidence that a cadre of economists questions the validity, and thus the usefulness, of the neoclassical synthesis. True, there is no unanimity among these dissenters about the theory they prefer, but there is a wide agreement that today's orthodox theory cannot explain significant facts about the American economy, that establishment theory is a poor guide to policy, and that, if the policy advice of those who adhere to standard theory is followed, the economy will deteriorate, not improve.

Nowhere is the intellectual bankruptcy and perversity of the political implications of the neoclassical synthesis more in evidence than in the treatment of inflation. The analytical content of Carter's speech of August 11, which was heralded as initiating a tough stance on inflation, comes down to the view that inflation can be stopped if the president makes clear that he is against inflation. One reason for the bankruptcy of political and the paralysis of action on inflation is the belief, induced into political leadership by their economist advisors, that a trade-off exists between unemployment and money wage rate changes.

Under both Republican and Democratic administrations, the economic advisors have recommended monetary or fiscal constraint to stop inflation. Such aggregate constraint first generates unemployment. The advisors have instructed the political leadership to hold that unemployment and excess capacity are good because they lead to a decrease in the rate of increase of wages and prices. Even though this 1984-ish prescription has less success than it did in 1966, 1969/70, and 1974/75, it remains the preferred "neoclassical" treatment of inflation.

Monetary and fiscal constraint do not work in the manner envisaged by the neoclassical synthesis because ongoing and increasing investment requires ever larger amounts of short-term financing as investment progresses toward completion. In these circumstances, interest rate

crease rapidly when monetary constraint is applied to halt an inflationary expansion. Rising interest rates increase costs for business and holders of capital and financial assets who use debt. This raises the supply price of investment output even as rising interest rates tend to decrease the value of capital assets. This leads to difficulties in financing and refinancing activity, which escalate until the weakest financial link breaks. The weakest links were banks that tried to make position by using municipal securities in 1966, the commercial paper market in 1969/70, and commercial banks and the Real Estates Investment Trusts in 1974/75.

The Federal Reserve's response to financing difficulties has been to increase high-powered money. The economy's response to financing difficulties has been a fall in output and a rise in unemployment. The government budget's response to falling output and increasing unemployment has been a huge increase in the deficit, because of both the "fiscal policy" response to unemployment and "built-in" stabilizers. As a result, embryonic financial crises, which result when monetary and fiscal constraints are used in a fragile financial environment, are first aborted by the Federal Reserve and then floated off by inflation.

The price level of consumer goods is a product of two ratios: one is the ratio of money wage rates in the production of consumer goods to the average productivity of labor in the production of consumer goods, and the second is the ratio of the incomes spent on consumer goods to the wage bill in consumer goods production. As a result, the higher the wage bill in the production of investment goods and the higher the deficit of the federal government due to government employment and transfer payments relative to the wage bill in the production of consumer goods, the higher the price level for any given money wage rate and labor productivity.

Our establishment policy-advising economists tell the political leadership that to increase employment and to increase the rate of growth, they should offer inducements to investment. They also favor various complex packages of transfer payments as antidepression and proequity devices. But increased investment and transfer payments are inflationary, for they increase the markup on wage costs that can be realized in the prices of consumer goods. Furthermore, the inducements to invest encourage debt financing and thus increase the likelihood of financial instability. Since economic policy has aimed to achieve growth through investment à la the neoclassical prescription, our economy has been more inflationary and more crisis prone than hitherto.

As long as the economist-advisors are wedded to the neoclassical view that allows them to ignore the financial characteristics of our economy even as they prescribe for our financially sophisticated economy, then the demonstrably futile charade of monetary and fiscal constraint followed by an inflationary float-off of a threatened crisis will continue. As long as investment goods production and the provisions of income or services by

transfer payments are the primary objective of policy, inflation, threatened financial crises, and periodic slumps are inevitable.

Many of the ills of our economy are due to beliefs about the nature of our economy induced in the political leadership by neoclassical theorists. Some beliefs that lead to policies which produce malfunctioning are: (1) that our economy can achieve — or be set upon — a stable, self-sustaining, and nonaccelerating growth path; (2) that the short-run changes in the rate of growth of the money supply are causes, not effects, of variations in overall economic activity; (3) that the overall balance, rather than the particular dimensions, of the government budget determines its effect upon inflation and employment; (4) that the evolution and adaptations of the financial system can be safely ignored; (5) and that the institutional structures of product and labor markets are largely irrelevant. These neoclassical propositions lead to policies that make our economic malaise at least in part "iatrogenic." Only as an economic theory that takes into account the financial and structural characteristics of our economy becomes the basis of policy, can we hope to do better than we have in the past decade.