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The Crises of 1983 and the Prospects for Advanced Capitalist Economies

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Introduction

In this paper I will examine and try to push forward our understanding of the crises that confront economies in 1983. These crises are:

1. the misbehavior of the economy,
2. the apparent breakdown of international financial relations,
3. the failures of economic policy and
4. the inability of economic theory either to explain what is happening or to furnish a guide to what can be done to make things better.

Although each crisis is important, the crisis in economic theory is perhaps the most interesting for the crisis in theory helps us understand the other crises.

When one labels "problems" or "unhappy developments" crises one adopts a dramatic language to characterize what is happening. Nevertheless the term "crisis" may be truly applicable to these various developments. If we mean by a "crisis" an unfavorable situation that needs resolution even as traditional or usual remedies seem to be ineffective, then the situation in the economy, in policy, and in economics as a discipline qualify as "crises."

Without the knowledge about economic relations and system behavior that relevant theory brings to the public and to policy analysis it is not possible to specify the way in which the performance of either the domestic or the international system is deficient nor or what policy can accomplish to make performance better. However even though today's dominant existing theory, the neoclassical synthesis, has been shown to have logical flaws and at best a restricted domain of relevance, a change from this dominant theory to another will not be brought about by the logic or the econometric testing of academics. Only as the world brings problems that must be addressed and only as the inherited theory fails to provide leads as to how to solve these serious problems will new theory replace the old. To a great extent the failure of the economy in terms of performance and the frustrations of policy are what will lead to the shift of paradigms that is needed.

This centennial symposium links three great economists, Marx, Schumpeter, and Keynes, who are alike in a number of ways. First—but perhaps most important—they are outsiders insofar as today's dominant theory is concerned. One could and I feel certain that many do go through a "rigorous" training in economics -even onto a Ph.D. -without any serious consideration of the economics of Marx, Schumpeter and Keynes. One of the reasons for this neglect is that they are alike in that they define the problem that economic theory must explain as the path of development of an accumulating capitalist economy through historical time, whereas the current dominant theory emphasizes exchange, and the allocation of given resource. Furthermore in Marx, Schumpeter, and Keynes the process of accumulation under capitalist conditions does not lead to smooth progress but rather to "explosions" and breakdowns, to booms and busts. In the economics of Marx, Schumpeter and Keynes, 'crises' are the normal result of the capitalist economic process. This leads to another way in which they are alike. Although Marx was a radical revolutionary, Schumpeter a conservative, and Keynes a trendy left-liberal they were all critical of capitalism as such. Their theories are not exercises in apologetics for capitalism; the notions that market processes yield "optimal" results are foreign to their thinking.

I will try to explain the various crises in economics and relate these crises to concerns that arise in the works of our "centennial" honorees, although, as I expect many know, I feel more comfortable dealing with ideas drawn from Keynes. However Keynes may be more relevant than either Marx or Schumpeter, for many of the aspects of our crises relate to the financial structure of capitalist economies and Keynes was more "modern" in his appreciation of finance than either Marx or Schumpeter. Furthermore Keynes wrote his "masterwork", The General Theme of Employment Interest and Money, with the great depression of 50 years ago as a "reference" point. The Great Depresssion is particularly relevant for an analysis of what exists today, ~~is~~, for much of what is bothering the capitalist economies is a fear that conditions are conducive to a financial collapse such as occurred in the first years of the 1930's. It is important to recall that the unravelling of the financial texture of the United States that may be said to have started in October of 1929 with the stock market crash was not completed until the bank holiday of March of 1933. The interactive debt deflation ran for more than 40 months before the full collapse took place. Even as we recognize that the financial traumas that seemed so threatening in July of 1982 have not as yet led to a thorough undermining of the financial structure, the awareness of continuing difficulty causes concern that further "crises" might yet occur. There may be an additional Penn-Square in the offing.

The Misbehavior of the Economy

In many ways the first two decades after World War II were a golden age of capitalism not only in the United States but also in Europe and other advanced capitalist economies. These economies succeeded in maintaining a close approximation to full employment even as inflation was constrained. As a result a wide diffusion of material well being took place. Propositions to the effect that capitalism was "good for" the "workers" as well as the owners of property seemed to be validated by performance.

These capitalist economies of the post-World War II era differed from the capitalist economies of earlier days in that government was both big—in the sense that government spending was a larger ratio to GNP than hitherto—and interventionist, in that it took responsiblity for (and the various administrations claimed credit for) the prosperity that was being achieved. The work of Keynes was interpreted as a guide to policy and in various ways the governments of the capitalist economies asserted that their policies were "Keynesian."

The government of the post-World War II era was big, not because of any socialization of industry, but because of "defense" and transfer payments. The set of transfer payments made up the Welfare State. The Welfare State was more a creature of William Beveredge than of Keynes. Whereas Keynes argued that a fairly comprehensive socialization of investment might be called for, the economies that were so successful in 1946-66 socialized and subsidized consumption. On the whole they did not promote or undertake investment.

citation

Over the 1950's and early 1960's -during this period of ~~on the whole~~ mainly tranquil expansion -a cumulative change in the financial structure took place that undermined the conditions that had made tranquil expansion possible. World War II came soon after a great debt deflation and depression. During World War II government spending and government debt in the hands of financial organizations, businesses and households expanded. As a rough and ready truth we can assert that at the end of World War II the ratios of private debt to both private income and public debt were very low.

citation

During the period of ~~on the whole~~ tranquil expansion serious cumulative changes in the liabilities of business and households, took place along with changes in the assets and liabilities of financial institutions. As a result of these changes that were due to profit-seeking behavior by the various actors in the economy, the susceptability of the financial structure to disruptions and trauma increased. ~~(See Charts I-VI at end of paper.)~~ [Add several sentences on what the charts show]

Debts are commitments to pay money on a dated schedule, on demand or if some circumstance (contingency) arises. The funds to meet such commitments are obtained either from income (wages and profits, taxes for government), by borrowing, or by selling assets. The liabilities on a balance sheet can be transformed into a time series of payment commitments even as the assets are expected to yield cash flows. The ratio between payment commitments and cash flows reflect contingencies that can affect the accumulation process. In a batch of papers over two decades I have drawn a distinction between hedge, speculative and Ponzi financing. citation Under ~~H~~hedge financing cash flows from assets exceed the full (both principal and interest) payment commitment on debts, whereas for "speculative"debtors the payment commitment on interest account are fully met by income but there is a need to rollover some maturing "principal." Furthermore hedge units typically have long term debt so that they are immunized from being affected by changes in market rate.

In addition to hedge and speculative financing units, there are "Ponzi" financing postures in which the cash flows on "income account" are not sufficient even to meet interest payments so that all or some of debt servicing costs are capitalized. Speculative and Ponzi units are not "immunized" with respect to changes in interest rate patterns. High interest rates will transform speculative into Ponzi units even as they increase the rate at which interest is being capitalized for Ponzi units.

The transition from the era of tranquil progress to turbulence was ushered in by a "mild crisis" in financial markets in 1966. This credit crunch was followed by the Penn Central crisis of 1969/70, the Franklin National-REIT debacle of 1974/75, the First of Pennsylvania/Hunt-Bache Silver Scandal of 1979, and the Penn Square/International crisis of mid year 1982. The financial market crises triggered recessions or retarded growth ~~recession~~, but because of a combination of government deficits that stabilized profits and Federal Reserve interventions that facilitated refinancing no cumulative debt deflation took place. We have

[is this the correct meaning?]

gone through several cycles since 1966 that have been characterized by:

1) a financial crisis that leads to intervention by the Federal Reserve.
2) massive government deficits that stabilize profits and provide default risk free assets for a restructuring of balance sheets.
3) a sharp fall in income and a rise in measured unemployment.

If we mark the cycles by the crisis years, — 1966,1969, 1974, 1979, 1982 — then the cycles were 3,5,5, and 3 years in duration. Furthermore the "peak" unemployment rates in the recessions, the minimum unemployment rates in the expansions, the maximum of interest rates and inflation rates, the measured rates of economic and productivity growth as well as the extent of financial distress during the crises show a "trend" of deterioration over these cycles. Although in each of the crisis episodes fears that the sky was about to fall were evident, the threatened interactive and cumulative debt deflation process was contained. The cycles and the deteriorating overall performance have hurt but as an overall phenomenon they have not been disastrous.

citation [or text table]

We are now into the fifth cycle, if we assume -as I think we should -that the combination of Penn-Square and Mexico in July of 1982 marked a financial trauma that led the Federal Reserve to interventions to facilitate refinancing. Both a sharp rise in unemployment and a fall in measured gross national product took place. In many dimensions of our financial economy—stretching from Poland through the Argentine, from International Harvester through the West Coast's "Whoops" to Baldwin-United and Tennessee banking — restructuring of debts and the working out of bankrupts without formal bankruptcies are taking place. Given the deficit of the Federal Government and the accomodating stance of the Federal Reserve, we can expect that the financial difficulties will be inflated out -- as they were in after 1969, 1974, and 1979. This time the inflation will occur in spite of a much weakened trade union movement. To paraphrase one of my favorite presidents -the one who resigned - "This time we won't have unions to push around and blame."

The big questions in today's economy ~~is~~ are when will inflation resume, ~~will~~ whether the expansion will have a relatively long stretch (say 36 months) or a short stretch (18 months), and when should portfolio managers rush into money even as asset prices collapse. Furthermore, ~~will~~ the question is now being seriously raised as to whether the sky will fall next time. ~~is a question being raised.~~ Thus even as fears of a deep decline "now" are eased, fears that inflationary turbulence will lead to another break and another threatened collapse are evident.

~~A.~~ International Financial Relations

One of the arenas of crisis is the international financial crisis which largely takes the form of massive dollar-denominated debts by a variety of "socialist" and "third-world" countries. The countries with massive international debt problems are at a range of levels of development, have many different oil involvements and differ in their social and economic structure. The only ~~"~~thing~~"~~ these countries have in common is that they are not advanced capitalist economies.

The essential elements of the international indebtedness problem are:

1. The payment commitments — both on account of principal due and interest — are large relative to (a) the (b) .
   ~~a.~~ size of the economy ~~and~~
   ~~b.~~ earnings of foreign exchange ~~and~~

citation

2. The debts to an overwhelming extent are denominated in dollars. There is a peculiar aspect of having these debts denominated in dollars, in that for much of this debt the parties involved are not "United States" based. A dollar-denominated debt of a Brazilian entity might be to a bank owned, chartered and domiciled in Germany and liabilities of this German bank may well be to say "Saudi" entities. Such dealings in dollars without U.S. involvement is especially marked when one considers operations such as the London branches of the international banks.

To a depositor in such an offshore bank the dollars on deposit in, say a "German" based bank is as much a dollar as any deposit in a New York office of a U.S. chartered bank. Thus the German chartered bank must earn dollar income and hold dollar assets. In particular it must hold assets that give it a quick command of dollars in New York. This means that there is a "financial transaction" and "debt based" demand for dollars that is quite independent of the current export-import balance.

If for example there are some $500 billion of dollar-denominated debts and the average interest rate on this debt is 10%, then there is a need for the debtor countries to acquire $50 billions of dollars just to meet interest ~~as~~ on their debt. Furthermore if the dollar-denominated debt grows by 10% in a year and the international banks keep 10% of their liabilities in quick dollar assets these banks will need to add some $5 billion of New York financial market assets to their portfolios. The result is a demand for dollars that can only be satisfied by onshore U.S. sources or holders of U.S. based assets.

As far as the international accounts are concerned the viability of a debt-structure depends upon debtors receiving an income cash-flow in the currency of denomination of their debts or in currencies that can be readily exchanged for the currency of denomination of their debts.

In the current situation this means that the United States must run a substantial deficit in its balance of trade. If we assume $500 billions of dollar determinated debtors and a 10% interest rate then the "order of magnitude" of the required U.S. deficit or trade account is $50 billions. The only modification that is necessary is to recognize that there are economies such as the Arabian states that have large holdings of dollar assets. A deficit in their trade account is a perfect substitute for a deficit in the U.S. trade account.

If a country with a dollar-denominated debt runs a surplus in a "third" currenc (pounds, marks etc.) the need to exchange, say marks for dollars to service debt will put pressure on the dollar mark exchange rate. Similarly and primarily a country with a large dollar debt will need run a surplus. This will, in a world with dollar-denominated debts, lead to the dollar seeking a level which encourages exports to the U.S. even as it discourages imports from the U.S.

The basic crisis in international financial relations flows from the need for a deficit in trade account from the United States. Such a deficit leads to unemployment and downward pressure on profits in the United States. The basic dilemma of policy is that the United States must run a deficit in its trade account. This deficit lowers profits in the United States and raises profits in the surplus countries. If with a given exchange rate/deficit of trade/U.S. unemployment posture the United States moves to an expansionary posture, then the United States may well move too far into deficit, which implies that a fall in the U.S. exchange rate will take place. Given the large amount of international trade, too great ~~in~~ an appreciation of the dollar can lead to a run from the dollar.

The floating exchange rate regime seems to be inconsistent with the highly integrated financial structure that now rules. With floating exchange rates and a large volume of debts denominated in other than the debtor's currency, official interventions that aim to stabilize exchange rates as well as rules of the game for changing the "stabilization band" seem necessary.

Given the size of the burden of debts of various countries, the possibility of default and rescue (or bailout) operations for various banks arises. These "bailouts" take the form of refinancing loans held by banks with accomodations from the World Bank, the International Money Fund or a consortium of private banks. Basically these refinancing relations keep~~s~~ the nominal equity of the banks unimpaired by removing non-performing, discounted, or in-default assets from their books and substituting cash for the impaired assets. If such refinancing did not occur then the equity of banks would have to be decreased; this in turn would lower the ability to lend and thus to finance by these banks.

Because of performance failure and the recognition of the limitations upon the ability of national economics to carry debts, banks and financial markets now have a greater reluctance to finance offshore programs than hitherto. If the equity of banks were compromised then the ability of banks to finance both international and domestic programs ~~will~~ would be impaired. Inasmuch as prosperity depends upon the financing of demand by banks, impairing the equity position of banks lowers their ability to finance, even as their willingness to finance has been diminished by performance.

It is necessary to either transfer "bad assets" off of the books of banks or to develop alternative institutions to finance resource creation, if the current and still developing problems of international finance are not to lead to serious constraints upon recovery and expansion. The problem with resisting bailouts is that without bailouts the future pays a high price for the excesses of the past. To develop institutions that can finance expansion, both domestically and offshore, in a way that does not lead to the enormous waste that was true of past development and expansion programs financed through banks, is a challenge of today. It is obviously true that the international banking system cannot claim that private, profit seeking banks are efficient in selecting only viable projects: the record of unwise and unwarranted financing is what causes this crisis.

We used $500 billion of indebtedness and a 10% interest rates for our examples. Let us assume the pattern of trade is such that the requisite $50 billion ~~dollar~~ deficit by the U.S. on trade account is being run. Let us further assume that inflation reigns and that United States monetary policy is ruled by monetarist precepts so that constraint in monetary growth is instituted regardless of the consequences for interest rates. If the interest rates jump to 20% then the carrying cost of the $500 billions of debts rises to $100 billion. As export and import relations are slow to adjust, an interest rate induced deficit of at least $50 billions in the rest of the world's payments account will take place. Given the institutional arrangements that rule, the extra $50 billions of interest costs will be added to the debt; interest is capitalized. The "extra" demand for dollars due to interest rate costs will lead to an increase in the exchange rate for dollars. This means that for debtors the domestic currency burden of the debt increases even more than the dollar-denominated debt.

It should be noted that the rise in international indebtedness due to the capitalization of interest is not due to (1) overambitious investment in development programs or (2) excessive consumption patterns. The linkages and the repercussions among economies that are tied together by financial relations are more complex — and more conducive to instability — than is indicated by models that look only to trade accounts and market processes that are reactions to disequilibrium in trade accounts.

~~IV.~~ The Failure of Economic Policy

The major failures of economic policy over the years since the credit crunch of 1966 can be summarized by noting that what is done to break inflation leads to what is diagnosed as at least an incipient financial crisis and what is done to abort the threatened financial crisis leads to an inflation. These cycles have taken from three to five years over the period 1966-1982. Furthermore these oscillations were accompanied by oscillations with increasing amplitudes in interest rates.

citation

These oscillations did not occur until after the financial structure became heavily weighted by debts and the debts became both increasingly short term and exotic in their various clauses and contingencies. The peaks of interest rates were accompanied by threats to the financial viabiity of firms and financial institutions. In each of the various financial crunches, liquidity squeezes or debacles of the years since 1966 the breakdown of some significant financial institution or market was at issue. The Federal Reserve was forced by these breakdowns to intervene, but to date the quieting of a crisis has only set the stage for a subsequent crisis which is seemingly more serious ~~crises.~~

One apparent cause of the failure of economic policy is that policy for an economy in which financial interrelations matter is being made by applying a set of theories within which financial relations have no place whatsoever. Our economy is an intensely financial capitalist economy; one aspect of this intense financialism is the vast amounts of professionally managed money in pension fund, trust departments of banks, mutual funds etc. This "money" is not tied down to particular assets or instruments. Increasingly the performance of the money manager is measured by the fund's total yield -which includes appreciation of values of assets as well as interest or dividends. The quest for performance so measured means that large blocs of funds are ready to jump from holding short term high yield "money assets" to stocks or bonds that have significant appreciation possibilities when interest rates decline (when stock and bond prices rise).

Such gyrations of portfolios by money managers seeking performance ratings would do little harm except that they amplify the fluctuations of interest rates and thus strongly affect the payment commitments that have to be explicitly or implicity made when financing investments. If the actions of the portfolio managers are to be likened to the activities of a gambling casino, then the profesionalization of money management has made enterprise financing ever more the byproduct of the activities of the casino.

Under the circumstances that now rule, a rational investor in long-lifed physical assets that have significant gestation periods undertakes projects with a recognition that financing terms are likely to change rapidly and perhaps reach conditions that are disastrous for the project's viability. The "uncertainties" of the capital development process are never trivial, but the way financial terms have gyrated since the mid 1960s has increased uncertainty. This uncertainty has served to diminish investment and as a result the "prosperity" of enterprise has been adversely affected. Economic policy must have as a major objective the stability of financing terms for investment, which in turn implies that interest rate movements need ~~by~~ to be constrained. However the increasingly powerful "monetarist" thrust to policy argues that in the short and long runs interest rates should not be a determinant of policy: monetary growth stability must be a well nigh exclusive policy goal! One aspect of the crisis in policy is the ~~alternate~~ result of the failure of monetarism as a guide to action and policy.

Is this the meaning?

Apologetics for this failure, to the effect that conditions weren't right, the Federal Reserve wasn't really monetarist, the reserve accounting process or some other triviality was wrong, are surfacing. Propositions ~~to the effect~~ that the Penn-Square/Mexico crisis of mid 1982 was not sufficient cause for the backdown from monetarism are being heard. However if the success of monetarism requires that a set of narrow precise conditions be met and if it also means that lender of last resort interventions are forbidden, then monetarism is not a guide to policy for our times.

The monetarist experiment of 1979-82 demonstrated that if policy is willing to tolerate large scale unused capacity and massive unemployment, transitory success against inflation can be achieved. However there has been no demonstration that unemployment can be reduced without reestablishing inflation. Inasmuch as the recent price stability was accomplished while the power of the oil cartel was weakened and as a rising dollar contributed to low dollar prices for imports, it is not at all clear that the inflation rate will not jump when these two developments abate.

There is another aspect to the failure of policy. The economic structure of the United States is largely the result of institutional evolution from a legislated structure put into place in response to the great depression of fifty years ago. This is the 100th anniversary of Marx's death, Schumpeter's birth and Keynes' birth but it is also the 50th anniversary of Roosevelt's inauguration. Some fifty years ago today the United States was approximately half-way through th ~~to~~ 100 days in which the institutional structure was radically modified. In the six years (1933-1938) perhaps ~~too~~ over impatient experimentation with the institutional structure of capitalism took place.

The experimentation and subsequent institutional evolution resulted in a big government capitalism in which government is big because of defense and transfer payments. Any economic system both allocates resources and creates resources. Government interventions that now rule are mainly concerned with maintaining consumption; there is no significant government involvement in resource creation aside from defense.

We have a cris~~e~~is in the transfer payment system as well as a crisis in the creation of human and physical resources. When Keynes advocated a larger role for the state, when he diagnosed the flaws in capitalism, he recommended a somewhat comprehensive socialization of investment" i.e. that the creation of resources be separated from the narrow profit calculus and be undertaken and stabilized with social purposes in mind.

[is this a quote? If so complete quotation marks and cite source]

In many ways, from impacts of the required trade deficit, on profits, the prevalence of "bet the company" types of investments at the technological frontier, and the problems of environmental protection the government needs to be involved in the resource creation process. As shown by the Chrysler and Lockheed cases and bank failures there has been and there will continue to be an ex-post (after failure) socialization of risks. We see this in ~~how~~ the way rate bases throughout the country will reflect the costs of abandoned and unwarranted investment in nuclear generating facilities.

American capitalism cannot be progressive unless there is some comprehensive socialization of several facets of investment activity. The policies and instrumentalities for such a transformation of the activities of government still have to be developed. One dimension of reform will certainly be a recognition that unemployment of youth, as well as early retirement induced by transfer payment restrictions are counterproductive; they reduce both human and physical resources.

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~~E~~. The Crisis in Theory

Even if economic theory was in good shape, in the sense that its theorems offered guides to policy and ~~if~~ policy which conformed to these guidelines would improve the performance of the economy ~~would be improved~~, there is no guarantee that policy would follow the precepts laid down by theory. This is so because policy reflects ideological interests. When policy makers wear ideological blinders policy will not reflect the findings of economics. When economists abdicate any responsibility to deal with the world as it is, then ideologies, masquerading as economi~~sts~~cs, will dominate policy. Economic theory is not in good shape. Even though the dominant economic theor~~y~~ies, monetarism and orthodox Keynesian~~s~~ism, have nothing to say about money, policy advice continues to be forthcoming from monetarists and orthodox Keynesians. You don't have to take my word about the irrelevance of today's respectable theory, for Frank Hahn, a neo-classical theorist, begins the text of his little book on inflation by noting:

> "The most serious challange that the existence of money poses to the theorist is this: the best developed model of the economy cannot find room for it. The best developed model is, of course, the Arrow-Debreu version of a Walrasian general equilibrium. A world in which all conceivable contingent future contracts are possible neither needs nor wants intrinsically worthless money. A first, and to a fastidious theorist difficult, task is to find an alternative construcion without thereby sacrificing the clarity and logical coherence that are such outstanding features of Arrow Debreu."

citation

Unfortunately after this insight Hahn continues to work within the Arrow-Debreau framework.

However the logical flow of making policy assertions about a monetary economy by using a theory that has no room for money is not the only "hole" in the logic of orthodox theory. In an economy with capital assets, the value of capital in place is the present value of future profits. However in the formulations of the value of capital used in neoclassical theory the value of capital is always the depreciated value of the original price; underlying the way capital is "valued" is the assumption that the depreciated original cost is always equal to the capitalization of future profits. However this equality ~~as~~ is an equilibrium proposition; the theory starts out by assuming the system ~~as~~ is in equilibrium, whereas the aim of the theory is to prove the existence of equilibrium. It has not been shown that a decentralized market economy that is accumulating and which has capitalist financial markets <u>has</u> an equilibrium, let alone that there exist~~s~~ market reactions to a disequilibrium such that the economy tends towards an equilibrium. Recent results on the nature of time series generated by time dependent non-linear systems show that apparent coherence is achieved because of constraints and interventions.

citation

These results imply that economic theory can no longer serve as an excuse or rationalization for laissez-faire. The question is not to rationalize intervention but to decide which system of intervention is best.

Conventional economic theory which incorporates monetarism and orthodox Keynesianism (best identified with the economists of the Kennedy -Johnson era), emphasizes the problems of resource allocation. The economics of Marx, Schumpeter and Keynes concentrated on the processes of resource creation. In Keynes, who is especially relevant for the problems of today, the problem that economic theory needs to address is the process of resource creation and resource management in a capitalist economy with sophisticated financial practices. The theorem that emerged from the analysis by Keynes was that the process of asset pricing leads to changing relations between asset prices and current output prices and these changing relations affected not only the desire to invest~~ment~~ but also, by way of

citation

investment, the ratio of employed to employable resources. In Keynes -as in Marx and Schumpeter-the allocation of resources is a problem that is subsidiary to the process by which resources are created.

Jane and Peter Grey have recently drawn a distinction between the stability

citation

and allocational efficiency of an economy. In order to judge the allocational efficiency or the stability efficiency of a system, a theory of system behavior which generates resource allocation and contains the possibility of instability is necessary. The Arrow-Debreau, model which underpins orthodox theory, is incapable of generating instability: the only way "disequilibrium" can exist in monetarism or in orthodox Keynesian theory is if an external shock occurs. Thus the orthodox theory is incapable of examining whether some institutional change or a policy interaction enhances or diminishes the stability efficiency of an economy.

Keynes' theory centers around a financial theory of investment and an investment theory of the business cycle. The evolution of the financial structure, as liabilities accumulate due to the behavior of asset holders and bankers, affects the stability of the economy. Observed instability is a normal system result and policy that stabilizes profits even as investment fluctuates will enhance the stability properties of the economy.

The economic theory of Keynes is much more relevant to the problems of the 80's than either the orthodox monetarism of Friedman, the rational expectations monetarism of Sargeant, or the traditional Keynesianism derived from Hicks. This is so because within Keynes' theory financial relations are endogenous; therefore ~~this means that~~ the effects of financial interventions can be evaluated. In a world plagued by instability economists or policy makers who hold that instability cannot occur as a result of the normal functioning of the economy are doomed to being ineffectual.

V. Conclusion

Thus there are many faces to the crises that confront the economy, economic policy and economic theory. Orthodox economics is of little help in furnishing guidelines to containing or controlling the crises in the economy. The economics of Keynes, which is related in the statement of the problem and the identification of what is at issue to the economics of Marx and Schumpeter, offers us the beginnings of a theoretical formulation which will help us "overcome" instability. However to overcome instability policy has to go beyond the operations of monetary and fiscal policy. Policy needs to enter upon the as yet uncharted course in which the rules for a somewhat comprehensive "socialization of investment" and the containment of liability structures are ~~being~~ to be examined.

[could this be expanded upon? see my letter]

It appears that big government enhances the stability properties of the economy even as big government, to a varying extent (depending upon ~~the~~ its structures ~~of the big government)~~, diminishes the efficiency of the economy (both in the macroeconomic sense of inflation and in its microeconomic allocation properties). In addition to a required research program that investigates the allocational efficiency impact of programs that enhance~~s~~ the stability of the economy, research is needed on the inflation properties of various regimes of stability —

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enhancing big government. Only by basing research on the paradigms of Marx, Keynes, and Schumpeter can we get guidelines to policies that will enhance the performance of our economy. ~~Whereas~~ is that all capitalisms are flawed, not all capitalisms are equally flawed, ~~is a~~ One message of Keynes. In practical terms the political problem is to again achieve, as we did in the fifties and sixties, transitory success by building an economic structure that constrains and offsets the flaws inherent in accumulating market economies.