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The Economic Problem at the End of the Second Millenium: Creating Capitalism, Reforming Capitalism, Making Capitalism Work

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THE ECONOMIC PROBLEM AT THE END OF THE SECOND MILLENNIUM:

CREATING CAPITALISM, REFORMING CAPITALISM AND MAKING CAPITALISM WORK

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Preface

During the first years of the tenth decade of the second millennium of the common era a wave of economic, political and social turbulence engulfed the established order throughout the world.

The fall of the Berlin wall signaled the consignment of the Lenin-Stalin model of Socialism to the dust bin of history.

The advanced capitalist economies, the United States and its Allies who were the presumed victors in the cold war, were mired in recessions, subjected to slow growth, buffeted by financial turbulence, and witness to a revival of know-nothing political movements that took up racist and fascist themes: even as capitalism triumphed the performance of Capitalist economies showed stresses and strains that raised questions about the future of the capitalisms that were so successful after world war 2.

The poor countries, what was once known as the third world, remained economically stagnant, politically erratic and socially irresponsible. For every success story of economic development and democratization an example of the failure of Capitalist development can be cited.

Strange and primitive religious movements along with ethnic divisions and conflicts have emerged in the former Soviet domains, the rich capitalist countries and the poor countries. Capitalism depends on some semblance of rational calculation, but the irrational seems to be in the ascendency even as the victory of capitalism in the cold war places a premium on rationality.

In the United States and Western Europe, the economic turbulence and relative failure of the 1990's stands in sharp contrast to a memory of the first two decades after the second world war when economic and social progress seemed to be universally possible, social discord seemed to be vanishing and the world was believed to be in a converging process of ever growing prosperity. The only blot on the horizon was the cold war. It was even hoped that economic success of the protagonists would lead to a thaw in the war.

The 1950's and early 1960's were not a golden age of either capitalism or Communism. However for the Capitalist countries of the west these years can stand as a "practical best". A practical best is full of difficulties, inequalities and uncertainties; it is not an Utopian golden age. However the problems seem surmountable and in many of the dimensions of society where shortfalls exist, seeming progress in correcting the shortfalls was the order of the day: we could all hold hands and join Martin Luther King in singing We Shall Overcome. Even as in retrospect the hopes of the era of Truman, Eisenhower and Kennedy seem naive. Nevertheless we must admit that progress was made and there were reasons to believe the present was better than the past and the future was going to be better.

In the narrow economic sense a practical best is a regime where a close approximation to full employment is realized, where full employment leads to economic growth and where the benefits of economic growth are widely distributed: The Kennedy aphorism, "A rising tide lifts all boats." characterizes an era in which a practical best is achieved.

It is now clear that the near term future belongs to capitalism, even as it is clear that there are many forms of capitalism. The hope for a reformed Socialism, the undefined socialism with a human face of Prague 1968, vanished with the failed Moscow coup of August 1991. The world economic problems in what is left of the second millennium and into the third can be summarized as creating capitalism, reforming capitalism and making capitalism work.

In the former Socialist countries the economic and political problem is to create capitalism. This means that the institutional framework for a capitalist economy needs to be created. This is not something that can be done overnight: a shock therapy may well be counter productive for it can lead to an institutional structure that sets up barriers to economic progress. In the 1990's as the creation of capitalism proceeds the institution builders need to keep in mind that capitalism was a failed economic system in the 1930's. Ss the first third of the twentieth century came to a close Hitler was in power in Germany and the capitalist democracies were in a great depression. It is too often forgotten that Hitler came to power in the months between Roosevelt's election and his taking office.

Serious systemic financial fragility became evident in the leading capitalist countries in the last years of the 1980's and became an epidemic during the first years of the 1990's. For the first time in more than fifty years financial fragility was accompanied by deteriorating performance and felt threats of depressions. The United States, Japan and Britain, (Wall Street, the City and the Tokyo financial community) experienced serious financial difficulties verging upon financial crises.

Theses potential financial crises were aborted by interventions by Central Banks, Special deposit insurance facilities, Treasuries or ad hoc Communities of Financiers. In the capitalist countries the total profits that business shared was sustained by government deficits not by the vigor of private investment.

The 1990's demonstrate that Laissez Faire is a non-starter as a guide to economic policy for capitalist countries. Large government deficits, which sustained the profits (the cash flows) of business and therefor enabled businesses on the whole to meet their commitments to bankers, prevented the capitalist economies from sinking into a deep and long depression. Central banking, unfettered by gold standard rules, prevented the fragility of the financial structure from leading to breakdown in the financing of business, households and government.

In the United States in 1990-1991 the government paid whatever was needed to refinance financial institutions, so that debt rescheduling and massive financial restructuring could be accomplished without a collapse of economic activity, even as reforms of the financial system and the way business is financed which might avoid such a debacle in the near future, were avoided. In the 1990's economic policy in the United States was not enlightened by an understanding of the difference between financially fragile and financially robust capitalist economies but was dominated by the hope, as Dickens' McCawber would have put it, that something will turn up so that the near term future will not be like the recent past.

Conventional economic analysis had little if nothing to say about why the crisis of the Bush years occurred and what is to be done to contain the thrust towards such crises in the future.

It almost seems as if the capitalist economies, and in particular the United States, needed the cold war to perform in a satisfactory way. The developments in the rich capitalist countries, as the Victory over Socialism was achieved, can be interpreted to mean that the stimulus of war, of the preparation for war or of a positive social equivalent to war is necessary for capitalism to perform well.

In the rich capitalist countries (United States, Western Europe, Japan and a few other wealthy capitalisms) the economic problem is to reform the institutions of capitalism so that once again the performance of the economy and society can be adjudged to be a practical best.

Over the ~~four~~ two score and seven years since World War 2 a large part of the non-communist non capitalist world had shown erratic progress at best. Much of the world which had thrown off the yoke of Imperialism after World War 2 was if anything no better off and perhaps even worse off than in mid century.

The systemic financial fragility, that was ~~threatened~~ evident in the United States in 1990 and 1991 with the crisis in the thrift institutions and the Commercial banks, implies that a debt deflation, which in the past had been associated with the deep and long depressions that characterized capitalism in the century prior to World War 2, ~~was~~ remains a distinct possibility, ~~in these years~~. The financial system was stabilized by a huge infusion of Government funds into the banking system and the threat of profit deflation, that would have resulted from the money crunch of 1990-1991, was contained by the beneficial effects of the government deficit upon aggregate profits.

In the aftermath of the Great Depression of the 1930's and World War 2, the countries that became the rich capitalist economies of the 1980's (Western Europe, North America, (consider Mexico, Japan and Australia-New Zealand) put in place barriers to the development of another Great Depression. These barriers consisted of big government with flexible tax and spending policies (so called Keynesian fiscal policies) and increased power and flexibility to the Central Bank, broadly defined. Big governments, either automatically or as the result of discretionary policies, were able to run stabilizing deficits which serve to contain the downside instability of aggregate profits and aggregate demand. The end of the gold standard straight jacket in the post war world, especially the move to flexible exchange rates, augmented the power of Central Banks, ancillary organizations that carried out specialized Central Bank functions (such as deposit Insurance in the United States) and Treasuries to intervene in the financial system as refinancing agencies. These refinancing actions typically aimed to assure that the commitments of specified private financial institutions would be honored. Such refinancing, or absorption by the public purse of what otherwise would have been a contagion of private losses, aborted debt deflation processes.

This system of dual barriers aimed to prevent 1) a disastrous decline in profits, employment, wages, output prices and national product and 2) a downward spiraling of asset prices, an explosion of failures of financial institutions (the inability of financial institutions to meet the commitments embodied in their liabilities) and the breakdown in the system that finances private investment spending.

In the past several years in the United States the protection in the form of deposit insurance against the consequences of the widespread failure of financial institutions and the deflation of asset values of was tested. The institutions own resources were found wanting and the Federal Government's contingent liability on the commitments of deposit insurance was, so to speak, "put" to the government. The Congress, reluctantly at times, has used the full faith and credit of the government furnished the funds to validate deposit insurance so that the deposit liabilities of Commercial banks and Savings and Loan Associations. It is clear that this funding of the commitment to support deposits aborted a serious depression, although it is not as yet clear whether the full dimensions of the problem have become apparent.

Thus even as Socialism fell the continuation of the long (1933-1990) era of capitalist prosperity and development, which began with the New Deal in the United states and continued with the Marshall Plan aided recovery in Europe and the Korean war aided recovery in Japan, was threatened. The capitalist world did not have much time to savor its victory. The political leadership and the policy making elites of the capitalist world have barely acknowledged that the financial structure needs to be repaired or reconstructed: financial reform is being forced onto the agenda by events.

As the cold war ended a great transformation of the power relations within the capitalist world took place. The power of the United States greatly decreased because the service it provided, the military shield protecting capitalism from a Soviet threat, lost its value. The international importance of Japan and Germany, the vanquished in war during the 1940's, increased greatly as they emerged as winners in the capitalist struggle for markets and financial dominance. The market dictated new power relations: what the German and Japanese legions had not been able to conquer the Mark and Yen have won.

For the United States the victory of Capitalism over Socialism may well have been a Pyrrhic victory. As the Soviet Union fell, the United States stood virtually exhausted: the United States was unable to transform its Military Victory in the Persian Gulf into a Political and Economic Victory. The outcome in the Gulf made it clear: the end of the cold war also marked the end of the American Century. One tombstone in the cemetery of Twentieth Century lost causes may well read: The American Century, 1918-1991. Unfortunately as we approach the Twenty first Century we cannot end such a Twentieth Century Tombstone with "May It Rest in Peace".

As we look towards the third millennium, the economic problems around the world can be addressed under three headings: creating capitalism, reforming capitalism and making capitalism work. In the former Soviet countries the problem is the creation of the institutional framework for capitalism. In the rich and the emerging capitalist economies there is a need to reform financial institutions and markets so that the threat of a global debt deflation is repressed and finance once again functions as an effective device for the capital development of the economies of the world rather than as a Casino in which asset value plays are the driving forces in financing decisions.

In all countries, rich and poor, Capitalist victors and Leninist-Stalinist vanquished alike there is a need to make capitalism work. Capitalism works well when, as in the 1950's and 1960's a close approximation to full employment is achieved and sustained and the benefits of the economy's economic growth are shared throughout the population.

It is quite clear that capitalism does not automatically work well. In the decade before the second World War capitalism was an abject failure. Even during the heyday of capitalism, the century (1815-1914) from Waterloo until the outbreak of World War 1, progress was regularly interrupted by hard times. Furthermore the benefits of economic growth were poorly distributed both within the populations of the capitalist countries and among the capitalist countries. Prior to the economic and political reconstruction after World War 2, Capitalism was not notably hospitable to democracy: Hitler's Germany, Mussolini's Italy, authoritarian Japan and the Tsar's Russia were all capitalist.

Even as Marxist Socialism is banished from social, political and economic agenda it is important to understand that its message resonated during much of the 20th century because of legitimate grievances against the outcomes of Capitalist economic processes. Even as it stands victorious a specter haunts capitalism. The specter is that once again it will perform as in the 1930's.

For a long time Heinz, the United States food company, had a slogan "57 Varieties", emblematic of the different types of pickles and condiments the company sold. The strength of capitalism is that it comes in at least 57 varieties. As one form fails, legislation and market evolution can lead to another form emerging.

In the New York Times of April 29th William R. Clines, a senior fellow with the Institute for International Economics in Washington, is quoted as envisaging a conflict between different models of Capitalism:

> "What could emerge is a period of competition between different capitalist models which all accept the premise that you have a right to private ownership and would acknowledge that private incentive is necessary for development. But there will be a debate between the Japanese model, which gives a bigger role to government planning, the U. S. model, which is essentially laissez-faire, and the European model, which gives more emphasis to social welfare.

Cline oversimplifies the varieties of capitalisms that are on the menu. The leaning of the American Economy towards laissez-faire in 1992 is not the same thing as the Gold Standard laissez faire of McKinley a century ago. The export oriented Japanese interventionist model of the 1990's is not the same as the imperialist and authoritarian Japanese interventionist model of the 1930's. Germany's Bismarkian paternalism is not the same as the social market economy of the current era.

It is difficult to accept that the United States is a laissez faire economy when the Congress authorized the issuance of hundreds of billions of government debt to assure that the depositors in Commercial Banks and Savings and Loans are insulated from the effects of the explosion of non-performing assets in the portfolios of these institutions. There is difference among capitalist economies in the proximate beneficiaries of intervention. In the United States interventions favor the owners of property. The provision of universal services seems to weigh more heavily in the European capitalist economies than in the United States.

In order to formulate the type of capitalist economy one wants to construct in the former Soviet areas, in order to determine how capitalist economies that are not now working well need to be reformed and in order to determine what needs to be done to make capitalism work, it is necessary to build upon Peter Albin's felicitous insight "each agent in the model has a model of the model". What exactly is the model of the model that guides an agent as he operates in the economy, an economist as he comments upon the economy, and a public official as he legislates or administers in his official capacity. This idea that legislators and the members of the policy public community have a model of the economy in their mind is of especial importance when an institutional structure is being created virtually de nova and when an institutional structure shows the stresses and strains that the richer capitalist economies such as the United States is now showing.

Complex, non-linear, multidimensional and time dependent interdependent systems, which combine structural relations and history to generate the present and the future, have a tendency to fly off into disordered and incoherent behavior: this is true of any such system regardless of how well it has behaved up until now. The emergence of incoherent behavior typically results from subtle cumulative impacts of repercussions of what happened in the past upon the present and upon the determinants of reactions. The successful operation of market economies requires positive interventions to create and support institutions that make for success in containing the tendency for incoherence to develop and to terminate those institutions that make for failure: the thrust towards incoherence needs to be thwarted by interventions due to either the created structure of the economy or by discretionary reactive policy.1 An institutional regime that serves the "world" well for a time may become, as a

1. Ferri and Minsky 1992

result of a cumulation of changes in relations, become a source of system threatening incoherence.

Capitalism, which is driven by profit seeking activities, is inherently evolutionary: strong institutions which sometimes binds and constrains and which other time promotes and induces entrepreneurial activity is necessary if capitalism is to be a viable economic order. It is a characteristic of the economic policy problem for capitalist regimes that an economic policy problem can never be solved once and for all: the evolutionary dynamic of Capitalism means that every particular institutional structure must be seen as a transitory state.2

It follows that a model of the model that treats capitalist economies as equilibrium seeking and sustaining systems, so that the economy can be "set on automatic pilot", so to speak, if once things are set right is misleading: it is a poor guide to economic institution construction.

However the situation is complex but not hopeless. There are properties of capitalist economies and rules of behavior of capitalist units that enable us to determine the broad parameters of the institutional structures for capitalist economies which are conducive to the economy working well.

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2. J.A. Schumpeter

THE ESSENTIAL CHARACTERISTICS OF CAPITALIST ECONOMIES

Capitalism is a system in which capital assets are privately owned so that humans own non human wealth. Furthermore this non human wealth can be legally traded. This means that there are prices for this non human wealth and a human's wealth is measured in the instrument in which this non-human wealth is measured and traded.

Production takes place by combining the labor of people and the services of capital assets. Capital assets in turn are in general owned by other than the persons whose labor is combined with their services to yield outputs. Workers can own their tools but not the capital assets with which they work. The output of production is sold at prices determined in output markets. These prices in general are denominated in the same instrument in which the prices of capital assets as well as wealth are denominated.

The capital assets of an economy consist of items which are transformed in the production process and items which are used as instruments and sites. The later items - the buildings and machinery - will participate in the production process for several to many units of output.

Thus in a capitalist economy not only are there prices for labor, for the services of capital assets, for capital assets as items and for current output but in addition there are prices for capital assets as combined into production units called plants and into owning and managing units called firms and for a mass of financial instruments which directly or indirectly are validated by the incomes of firms, of households and government units. All of these prices are measured in a common unit, the money of the economy.[3]

Capitalism is not a system in which the instruments used in production are so cheap that the representative workman can own the tools needed for his activities. Furthermore in modern capitalism the cost as current output of capital assets, i.e. the cost of investment output, is typically beyond the wealth of even the richest of individuals.

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3. In truth a rational socialist economy, of the type envisaged in the 1930's by A.P. Lerner and Oscar Lange, would have almost all of the prices as a capitalist economy. (Some of the complex financial instruments of a capitalist economy might be "missing".) Furthermore in a rational socialist economy the same accounting principles, which center around balance sheets, income statements and sources and uses of funds, would apply.

In the 1930's vision of Oscar Lange socialism was a technique for achieving a higher level of product and capital market efficiencies than was possible in a monopoly ridden capitalism which was demonstrably unable to achieve and sustain a close approximation to full employment. In particular the capital "market" of a Socialist economy would not be subject to the speculative waves and the manipulation of liability structures that led Keynes to compare the capital development of a country to the activities of a Casino.

If we examine the behavior in the world's capital markets in the 1980's and 90's and examine critically what was and was not financed it is evident that the modern capital markets are as lief to the misallocation of resources now as in the 1920's and earlier.

The corporation is the social artifact of modern capitalist economies that is used to organize production that requires expensive capital assets. The fundamental aspect of corporations, or more generally firms, is a balance sheet in which the non-human capital assets are listed as assets and the liabilities which consist of a hierarchy of claims on the earnings of the corporation and the upon hypothecated assets. The claims are commitments of various types. In a well working capitalist legal system the status of the claimants and their remedies if the commitments are not honored ~~is~~ are well defined. Bankruptcy results from not honoring claims and each capitalist economy has more or less well structured bankruptcy laws.

Bankruptcy is concerned with the control and operation of capital assets: with who manages capital assets as collected into operating organizations and how this management is changed, There is a current crises in American capitalism centering around the control of management by the presumed owners of corporations, the stockholders and whether bankruptcy protects the corporation as a going concern or the creditors.

The fundamental structure of a capitalist economy contains four types of units: Households, ~~B~~business firms, banks and a government. Furthermore a capitalist economy has a "paper" world that parallels the world of production and consumption. This paper world can be characterized as consisting of an inventory of commitments to make cash payments through time, the current fulfillment of such commitments and the undertaking of commitments today to make payments in the future. Thus Capitalism is an economy in which contractual commitments to pay cash are critical.

THE CREATION OF CAPITALISM

Every agent in the economy has a model of the economy in mind when he makes his decisions. This is the essential contribution of the rational expectations revolution. The strong conclusions of the Rational Expectations school of economics depended upon the agents in the model having a general equilibrium model of the economy "in mind", not because the agents in the economy were trained economists but because experience has taught each agent to behave as if he had such a model in mind. The assumption is that if an agent operates with anything but a valid general Equilibrium in mind the agent will be punished by losses. This implies a collective memory of what happens to agents under capitalism. Thus if an economy is moving from socialism to capitalism one of the essential ingredients for the ability of markets to achieve properly set prices is missing. The missing piece is that agents know "their place" in the economy and that the expectations that guide the behavior of agents is consistent with what the model in fact assigns to them, This model consistent knowledge is especially important in determining investment and the data needed for model consistent investment is missing in an economy that is making the transition from Socialism to Capitalism.

THE TWO VIEWS OF CAPITALISM

There really are two views of what a market economy achieves and how it achieves it. One view, which we can call the Smithies view takes as the key to its doctrine the inviable hand proposition of Smith:

> As every individual, therefore endeavors as much as he can both to employ his capital in the support of domestic industry, and so to direct that industry so that its produce may be of the greatest value; every individual necessarily labors to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it....and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention.[4]

This invisible hand proposition of Smith became the foundation not only of the orthodox economic theory of Marshall and Walras and therefor the foundation of the modern mathematical economics which reached its fulfillment in the by now classic demonstration by Arrow and Debreau that a competitive equilibrium exists, that the equilibrium is a Pareto optimum and that it fulfills the Smithies criteria of promoting the public interest. A further inference that is drawn from Arrow Debreau, which is quite

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4. Adam Smith <u>The Wealth of Nations</u>

unwarranted, is that it is supportive of the ideology of laissez faire.[5]

As Frank Hah has acknowledged the economics of Arrow Debreau has "no place for money".6 Furthermore it has no place for time, capital and finance. It is most clearly relevant to some abstract trading game, and even there it rests upon a quite unacceptable assumption of perfect foresight.

The Smithies perspective, as formalized by general equilibrium theorists, embodies an axiom of reals: the preference systems and production functions, that are the core of the theory, are over real variables. It follows that the only monetary theory compatible with general equilibrium theory is the Quantity theory of money which has as its main proposition the neutrality of money.

The neutrality of money is a central tenet of monetarism and of all neo classical macroeconomic theory. The implications of the Smithies view are as Milton Friedman put it:

> "...despite the important role of enterprise and of money in our actual economy and despite the numerous and complex problems they raise, the central characteristic of the market technique of achieving coordination is fully displayed in the simple exchange economy that contains neither enterprises nor money".

There is an alternative to the neoclassical theory and the quantity theory to which it leads. The "motto" for such theory can be the following from J.M. Keynes:

5. Ingrau and Israel
6. Frank Hah, Money and Inflation, MIT Press, 1983

> If I may be allowed to appropriate the term speculation for the activity of forecasting the psychology of the market, and the term enterprise for the activity of forecasting the prospective yield of assets over their whole life, it is by no means always the case that speculation predominates over enterprise. As the organization of investment markets improves, the risk of the predominance of speculation does, however, increase....Speculators may do no harm as bubbles on a sea of speculation. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes the by-product of the activities of a casino, the job is likely to be ill-done.[7]

The significant aspect of the above citation from Keynes for the purposes of creating capitalism is that it shifts the focus from the Smithies trading of what is already produced, with production means and techniques that are outside the field of discourse, to the capital development of the country. If one needs to create the financial institutions of a capitalist economy de nova, then the rules and objectives of the institutions that are created will reflect the model of the model that those who are engaged in this process believe to be valid.

If the institution creating agents conceive of economic society as a trading game (the model is an economy of "handlers") then the function of the monetary and financial system is to facilitate trade, so that the double coincidence of wants that barter requires does not act as a barrier to trade. Such a financial system will be

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7. J.M. Keynes, The General Theory of Employment Interest and Money, 1936, p159

constrained in the instruments it will allow and the institutions will be constrained in the credit facilities they can extend. In particular the monetary institutions will be divorced from the investment process.

If the institution creating agents hold that the capital development of the economy is the primary objective of economic policy and that the financial system that is developed should be designed to facilitate the capital development, then the monetary and financial institutions they will promote will be centrally concerned with the process by which investment and positions in capital assets are financed.

In particular those who hire advisors for economic policy and those who formulate the institutional structure should be required to spell out the model of the model they use in formulating the advise they advance.

INTRODUCTION

The transformation of society in Eastern Europe has proceeded much faster and the destruction of the legitimacy as well as the efficacy of communism has been more complete than was deemed possible when the process began. Like all revolutions it has not been a reasoned and deliberate process: no one has been in charge and no coherent view of the society the revolution aims to achieve has emerged. The rapid movement of history has replaced the initial aim of achieving socialist market economies by a goal of achieving a rapid transformation to a capitalist economy.

The transformation started even as there is no serious body of available literature on problems of the transition from a command or planned socialist economy to capitalism: there is no body of economic theory that enables one to go from the shock therapy to an effective structure for creating capital. What has been happening has been both rapid and helter-skelter: furthermore these changes are taking place in a political situation dominated by public impatience. However real results take time: an idea that is not popular in societies in which so much has been sacrificed for so long to build a better tomorrow, only to learn that no such building was taking place.[1]

1. It almost seems self evident that the so called planned economies were not in any serious sense planned. In serious planning the general interdependent relations in production

There is little in the discussion that I know of, and I do not claim to be into the large literature that I am sure has developed on the subject of the transition, about the salient fact that differentiates capitalist economies, whether conservative or social democratic, from economies based on Leninist - Stalinist principles: the salient fact being that market economies are <u>financial systems</u> by which the incomes and the wealth that are earned in production and distribution are transformed into personal claims to income and personal wealth. In a capitalist economy the basic economic units have a net worth, they own wealth.

Furthermore the financial system not only transforms the value of the productive capacity of the economy into private wealth but it also plays a key part in the process by which investment takes place. In a modern economy the demand for investment outputs takes the form of an ability to spend money to obtain the complex and expensive plants and machineries needed for modern production. Money "now" is needed for such projects and the financial system is the mechanism by which investing firms obtain the money now in exchange for promises to pay money "later". The money "later" which enables the commitments undertaken in financing contracts to be fulfilled is to be obtained from

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and consumption are considered. The obvious disregard of the conditions of the labor force and of the environmental impact of industry in the Eastern European economies is prima facia evidence that interdependent relations were disregarded, i.e. development was anarchic not planned.

the receipts that the project is expected to generate i.e. by the profits enterprises are expected to earn. It is important to note that the financial system of a capitalist economy links the past, the present and the future.

There are many different financial structures in history, in existence and in our ability to invent for capitalist economies. These alternative financial systems have different impacts not only upon the static efficiency of an economy but also upon its growth and stability. Furthermore the financial structure is a major determinant of the distribution of power in the economy. Therefor there are choices that need to be made, options that need to be considered. What we are doing in this paper is sketching some attributes of financial systems so that the transformation to capitalism can be informed.

FINANCIAL SYSTEMS

Financial systems consist of institutions, such as commercial banks, investment banks, pension funds etc., instruments, such as common stocks, bonds, bank debts, deposits, etc. and markets, such as the stock and money markets. In the markets the various financial instruments are made and traded. The details of the functioning of the stock and money markets depend upon the structure of financial institutions and instruments. Many of the important markets are markets in which institutions operate more than individual households.

Financial commitments are owned by units in the economy and to these owning units they are claims to receive incomes in the future. These commitments are first created in an exchange where money is paid today in exchange for particular claims to future incomes or cash flows. The cash flows, above what are needed to meet wage bills, tax bills and purchases from other units, to the holders of financial instruments are conventionally called gross profits. As a result of past promises, the cash flows (gross profits) that are realized at any date are allocated among claimants as stated by the stock of outstanding financial instruments and entries on the books of financial institutions.

These claims are accepted as legitimate in the society because the right to these cash payments were created by prior payments: rents, interest and dividends are legitimate because they reflect the money later part of trades in which money now was exchanged for money later. The money now paid for investment output, state spending or foreign goods. Those who acquire financial instruments from the market after they have been created in some initial financing transaction acquire legitimacy for their claims from the original transaction.

It is obvious that questions of the legitimacy of rights to future income can arise in the privatization of a public domain: the difference between the honest homesteader and the Robber Barons in American history comes to mind. The lesson from history is that privatization should be done very carefully especially, if the capital assets were created without initial private financing. Questions of how to create legitimate titles need to be addressed in the discussion of the transformation of Eastern Europe. In particular the legitimacy of granting titles to those who now occupy key positions in existing productive capacity may be questionable.2

In a capitalist economy investment and positions in capital assets are financed by exchanges of money now for money later. The receiver of the money now presumably uses the funds to invest and has an acceptable answer to the essential banker's question "How are you going to get the monies to repay me?".[3] The financial system thus provides for linkages through time: exchanges of money for well defined claims to future money flows are made each day. Furthermore each day is the future of deals that were struck in the past. The financial structure and the physical capital assets of a capitalist economy link the present to the past and to the future.[4]

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2. The scheme of giving each person one share in every enterprise or a set of enterprises seems like a way of assuring managerial control.

3. The money now for financing investment includes earnings retained rather than distributed: presumably the in-house decisions relating to retained earnings pass the same test as the external financing. We also know that many cases can be cited where the presumption is unwarranted. A major problem in Capitalist economies is to develop devices by which the management of corporations operate in the interests of the stock holders, the presumptive owners.

4. In a Leninist-Stalinist socialism the link of today to the past is only in the capital assets available for use

CAPITALIST COMPLEXITY AND THE RELEVANCE OF ECONOMIC THEORY.

Because of these financial linkages in a capitalist economy between the past the present and the future, which is always conjectural, simple linear models that abstract from money and finance violate the true character of a capitalist economy. In particular business cycles that are linked to endogenous financial crises and the pay off from government regulation and intervention which prevent or contain crises and depressions are non starters when a theoretical structure where money and finance are ignored is used for policy making.[5] Policy making for the economies that are building market economies from so to speak scratch should take the advise of those who's basic economic theory either ignores finance or reaches the conclusion that finance doesn't matter with the proverbial grain of salt.

As a result of financial linkages economists are recognizing that capitalist economies are best modeled as complex non-linear time dependent systems then it follows

today and the link of today to the future is by way of gross investment and capital that is carried over.

5. The Savings and Loan crisis in the United States is a result of the gradual breakdown of the regulatory system over the post war period and a corrupting of the regulatory system in the 1980's. What is being called the bailout is the use of government fiscal strength to prevent the breakdown of the S&L's from triggering a big depression. Because the government is being operated by those who accept the advice of good ole neo classical economists - in neoclassical theory finance really does not matter - they know not what is happening and they therefor know not what to do.

that the path through time of capitalist economies are likely to exhibit periods of incoherence, of instability that is due to the characteristics of the system rather than to any inept or malevolent shocks.[6]

THE SURPLUS AND FINANCE.

In any economy where investment takes place - or where there is a court, an army, a priesthood or net production for the use of foreigners - the total of wages paid is greater than the wages paid in the production of the goods wage earners will buy. Put it simply wage workers producing investment output or who serve the person of the Prince have to eat. As a result the price of the goods wage earners buy is greater than the labor costs in producing these goods. This elementary relation indicates that there will be a financial surplus: gross profits will be earned in the

6. It is well known that multidimensional non linear time dependent systems are almost certain to generate complex time paths. If economies are modeled as such systems then fully endogenous incoherent behavior will take place. In such models runs of coherent behavior are the result of interventions and constraints. The floors and ceilings business cycle models of some 30 years ago can now be generalized.

For an exposition of the economics of chaotic systems see W. Baumal and J. Benhabib Chaos: Significance, Mechanism and Economic Application" JEL 1989.

For floors and ceilings business cycle models see JR Hicks, A Contribution to the Theory of the Trade Cycle (new York, Oxford University Press, 1949) and HP Minsky "Monetary Systems and Accelerator Models" AER 1957 and HP Minsky "A Linear Model of Cyclical Growth." RE STAT 1959 production of consumer goods and these profits will depend upon the relation between the total wages paid for the production of consumers goods and the total wages paid in the production of investment goods.7

In a capitalist economy the financial surplus which is forced by investment spending takes the form of profits. Two attributes of any capitalist economy are affected by its financial system: the allocation of the gross profits of the economy among claimants and the financing of spending in such a manner that the composition of demand generates a surplus. Profits, which are the flows that do or do not validate the financial instruments that are outstanding, are the lure that induces business men to invest and bankers to finance investment.

At the level of the individual unit and the particular financing deal the financing of investment takes place because a *pro forma* (a projection of revenues and costs, of cash flows) convinces the business man and the financier that the project will be profitable.8 The business man answers the financier's question "How will you get the

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7. For a further explication of these relations see M. Kalecki, Selected Essays on the Dynamics of the Capitalist Economy (Cambridge, Cambridge University Press, 1971), D.and S. J. Levy Profits and the Future of the American Society and H. P. Minsky Stabilizing an Unstable Economy (New Haven, Yale University Press, 1986)

8 Pro formas may be considered as the basic documents of an investing capitalist economy. The pro formas are the embodiment of the strong budget constraint, for it specifies costs and revenue situations which will lead to failure.

monies to meet the obligations to pay you are accepting?" by pointing to the prospective costs and revenues.9

Assumptions about future economic conditions underlie these *pro formas*. When the construction and land development deals in Texas that undid Banks and S&L's in that state were entered upon a not unusual assumption was that oil was heading towards ninety dollars a barrel.

A bankers cliche is "I've never seen a *pro forma* I didn't like.", i.e. those seeking financing always present a favorable view of what will take place. In the business of capitalist financing it is the duty of the banker to be the skeptic. One suspends disbelief when one goes to the theater, but one does not suspend disbelief in the board room where financing decisions are made.[10] If the aggregate economic conditions that were assumed in the *pro formas* of 1980 were realized in 1990 there would have been no S&L debacle.

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9. The pro forma's, ie the presentations that business men make to bankers and that division chiefs make to the finance committee may be envisaged as the cost curves and the demand curves of economic theory: these concepts being "ex-ante". In the average cost diagram of the text books the achieving of prices and output combinations within the cup of the U shaped average cost curve means that the financing commitments that enter into the drawing of the diagram - in the preparation of the pro forma's have taken place. Note that the type of market power envisaged for the project is part of the financing proposal. Bankers and financiers in general abhor competitive market conditions: financing is more readily available to those who can project some market power. In an investing capitalist economy there is a contradiction in the competitive market assumption.

10 I wish to cite what I call William Janeway's first law, "Entrepreneurs lie." Minsky's corollary is "Banker's also lie."

The financial system of a capitalist economy allocates the realized surplus to individual claimants - creating interest, dividends and retained earnings incomes. It also uses the financial system to finance investment, government deficits, export surpluses, and consumer spending in excess of the internally generated cash.

The operations of the financial system finances demands that force a surplus out of the economy. Financed investment, financed government deficits, financed trade surpluses and financed consumer spending in excess of consumer incomes forces the surplus which takes the form of money flows that may or may not be large enough to validate claims to income that are legacies of past financing decisions.

I state these elementary truths in order to make the point that the transformation of socialist economy into a market economy involves the creation of a financial system. However the social and economic revolution in the once socialist economies is so profound and so wide that it is impossible to create reasonable or believable *pro formas*. In the formerly Socialist economies there exists no rational basis by which to project future profits for existing enterprises let alone for new projects. This implies that the financiers will be required to make great leaps of faith, which in the light of the continuing problems with the recent leaps of faith in Latin America, leveraged buy outs and real estate seems unlikely, or that the financing of investment will be based on considerations other than the submission of acceptable *pro formas*. Financing, whether domestic or foreign, in the absence of acceptable pro formas depends upon political considerations. The political considerations will either be domestic, which implies a continued socialization of the investment process[11] or they will be foreign, which implies a dependency (colonial) status for the new emerging capitalisms. [12]

The pro forma perspective on the operation of a capitalist economy also tells us what the priorities should be in the former Socialist countries: operate the economy so that the data needed for the evaluation of the worth of capital assets and investment projects is generated.

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11. This phrase consciously echoes Keynes.

12. As a result of the great collapse of the financial system between 1929 and 1933 believable pro formas were not forthcoming from private business for sufficient investment to generate a close approximation to full employment. Keynesian deficit financing was a substitute for private investment in both generating income and forcing a surplus (profits) on the economy. Government guarantees of private financing was another way to generate acceptable pro-formas so that private financing of investment took place. The seeds of the 1990's S&L debacle which rest upon government guarantees of private financing were planted in the 1930"s.

FINANCING SYSTEMS

There are great differences in the financial systems of the various capitalist economies. Furthermore the financial system in any economy at any time differs from the financial system of the same economy at an earlier or a later date.[13]

Financial systems of capitalist economies evolve in response to perceived profit opportunities in financing and refinancing businesses and in adjusting portfolios.[14] Financiers are profit seeking business men and financial innovation is an endogenous phenomena. Even without the prompting of Professor Schumpeter, J. P. Morgan well understood that the acquisition of market power was the way to acquire assured profits if the macro economics were such that the flow of profits was variable.[15] As a result of the impact of the financial systems of capitalism upon the decisions that can be implemented, the actual operations of a capitalist economy differs from the that of the models

13. The history of the United States can be written in terms of attempts to get the financial system right. From the first and second banks of the United states through the Jackson era of free banking to the New Deal of Franklin Roosevelt there has been a conflict between those who look to the financial system as a means of supplying a safe and secure medium of exchange and those who look to the financial system as a facilitator of the capital development of the economy.

14 HP Minsky Central Banking and Money Market Changes Quarterly Journal of Economics, 1957.

15..Joseph Schumpeter "The Theory of Economic Development" (Cambridge, Harvard University Press, 1936) is the classic English translation of a volume that had appeared in German some 30 years earlier.

developed in the formal theory, where the analysis is carried out abstracting from the existence of money. Theory that abstracts from money and finance, such as Arrow Debreau, Arrow Hah and even the scribbling of monetarists,[16] are poor guides for understanding problems involved in the transformation of the hitherto socialist economies into capitalist economies: the analysis which abstracts from money and finance cannot be expected to lead to blueprints for the design of the financial institutions of newly emerging market economies.

The critical problem that the transformation needs to solve is: create a monetary and financial system which will facilitate economic development, the emergence of democracy and the integration with the capitalist world. In this transition the control of property needs to move from the planning authorities to decentralized production units (enterprises) and the objective of managements needs to be the earning of profits in the market.[17]

16.. K. Arrow and G. Debreau, "The Existence of Equilibrium for a Competitive Economy" Econometrica, 22, G. Debreau, The Theory of Value (New York, Wiley, 1959), K Arrow and F Hah General Competitive Analysis (San Francisco, Holder Day, 1971) and D. Laidler, The Demand for Money, Scranton, International Text Book company, 1970)

17. Note that there are models of Socialism in which decentralized enterprises seek to earn the best possible profits in decentralized markets. Oscar Lange "On the Economic Theory of Socialism", (Minneapolis, University of Minnesota Press 1938) is the classic statement.

The Heinz Company, the well known canner of pickles and purveyor of ketchup used to have a slogan 57 varieties to describe the wide scope of the products it offered. I used to say that there are as many varieties of capitalism as Heinz had of pickles, and that this very variety of the capitalisms that are in place or which have been in place or which will be put in place is responsible for the resilience of capitalism. Capitalism is both intermittently fragile and resilient. Even as events show that a particular form of capitalism is a failure - as the great depression showed that small government laissez-faire capitalism was a failure - other forms emerge. Thus the emergence of big government interventionist capitalism in the period leading up to and after the second World War was a response to the reasons that were advanced for the failure of capitalism between 1929 and 1933. This form of capitalism has had a successful run of about forty years in the United States.

The current problems of American Capitalism may be interpreted as the aging of the 1933-36 Roosevelt reformation of capitalism and the attempt under Reagan and Bush to reform that now aged capitalism by returning to the failed model of the pre 1930's era. European capitalisms, where the use of the state for public purposes is in better repute than in the States, may be more successful in the foreseeable future because they are more flexible. Japan is off on a different course of a controlled and manipulated market economy which so far seems to need to sustain its flow of profits by massive export surpluses. Japan's prosperity may be very fragile, for it seems to depend upon technical virtuosity and strong export surpluses. Given its acquisition of foreign assets Japan has to turn into an import surplus economy if the profit flows of those who owe it money are to be able to sustain the liabilities.

The existence of a wide variety of capitalisms and a wide variety of capitalist financial structures makes the problem of designing the financial system for the economic order that will form in the newly emerging economies to the east of the common market more difficult. It also makes an understanding of the alternative financial structures which are possible and their likely impact upon efficiency, development and distribution important as we begin to write on the largely blank slate that is Eastern Europe.

BALANCE SHEETS

A fundamental attribute of capitalist economies is that each unit has a balance sheet and these balance sheets are interrelated. The capital assets in the economy, the plants, equipment and land that constitute the basic non human productive capacity of the economy, are one set of assets in these balance sheets. In the early stages of capitalism, before the rise of the corporation and when yeomen or lords owned land and say cattle, the actual real things may well have entered the (implicit) accounts: accounts were more like inventories than balance sheets. But as soon as the operator or the ostensible owner of assets began to finance part of the "position" in assets with financial instruments the simple enumeration of assets had to be replaced with a value of assets. It is convenient to value assets in the same currency as the debts are stated. In a modern capitalist economy such simple private ownership has been replaced with corporate ownership: the proximate owners of capital assets are now corporation. The simple ownership of the capital assets of the economy by individuals or even partnerships, as was true in olden days, has been replaced by corporations with complex liability structures. A complex combination of equity shares, bonds, mortgages, leases and bank loans finance the control of the capital assets that are needed for production.

In such a modern corporate world the liability side of the balance sheet has to be interpreted as a claim by other units to cash payments: liabilities of one unit are assets of another. The various instruments used to finance the position are dated, demand or contingent claims to the cash flows that the operations of the unit, operations that depend upon the use of the physical assets, generate. The essential time dimension which is an essential aspect of capitalism arises for unless the claims to cash are all contingent, depending upon the performance of the organization that issued the liabilities, the commitment to make precisely defined dated payments are entered upon before the funds are realized. The performance in the present may or may not validate commitments that were made in the past. This intertemporal nature of the financial relations of a capitalist economy is the essential reason why capitalist economies are likely not to behave in a nice equilibrium seeking way and why markets need to be regulated and controlled.

The real assets in the balance sheet of productive units are not liabilities of any economic unit. The liabilities that are used to finance these positions are in turn assets in other balance sheets.

The paper world of financial instruments connects various balance sheets. In simple worlds the liabilities of production units would be assets in household balance sheets and households would directly receive the payments committed on these liabilities. In modern capitalist economies many balance sheets are interposed between the two ultimates: the firms that are the proximate owners of capital and the household who are the ultimate owners of the wealth of the world.[18]

The simplest intermediary owner of the liabilities used to finance positions in capital assets are banks, which interpose their guarantees between the operator of capital assets and the owners of bank liabilities. The power of this guarantee has been such that bank liabilities became means of payments, became the money of the economy. The holding of bank liabilities were deemed to be a secure and necessary part of the wealth holdings. Because of the ways in which the profit driven creation of the means of payment was able to force surpluses and because of the instability consequences of repudiations of the agreement to make payments by banks, central banks were invented as banking became ever more important in the economy.

Because banks had payment commitments to the holders of their liabilities, good bank management led to banks specializing in the financing of commerce, the movement of finished goods through the production process.

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18. There are organizations such as Universities with their endowments which are artificial households.

The financing of capital assets was outside the banking system. Households and partnerships financed capital asset ownership. Specialized financial institutions, such as the savings and loan associations of ill repute and insurance companies financed some longer term assets. As technology changed the need for longer term financing became more pronounced. The development of specialized financing organizations and markets, the stretching of the banks to finance capital assets and various state interventions to foster the financing of industry were responses to the changes in technology and in scale.

VARIETIES OF FINANCIAL STRUCTURES.

Distinguish three kinds: commercial and other specialized banks and an investment capital market, universal banks and commercial, and intermediate credit banks and public holding companies. Argue that the transition calls for a variant of the public holding company where the state and the public holding company are using there device as a transitional mechanism to prepare units for rational privatization. The United state's RFC may be an example to build on.

We do not want to do genesis, we don't even want to do evolution. We want to examine the options the emerging economies of Eastern Europe have with respect to their financial structure. One fundamental aspect of the economies that are emerging from Communism is there is no private wealth even thought here are capital assets which are used in production. This is so because the capital assets of the economy - the power generating plants, the factories, the farms and the housing properties - are not measured in the unit of account and liabilities, which are claims to the profit flows these capital assets are expected to earn, are not entered as assets in either household balance sheets or in the balance sheets of intermediaries which in turn have liabilities to households. As there is no history of profits earned that is really relevant to the emerging economy there is no way to generate such values.

Furthermore there is no simple way to create legitimate private claims on future cash flows which because they are marketable are priced and therefor are wealth. This is so because it is not possible to impute the creation of specific capital assets to some specific earlier exchange of money today for money tomorrow where the money today came from some restricted class of individuals.

Financial structures of capitalist economies differ in the importance and strength of institutions and markets. Banks that are mainly restricted to short term financing of business and financing household positions in primary securities and housing will be dominant in economies with a strong market for primary debts and equities. This structure requires that there be many individually managed portfolios and that households are willing to invest directly in corporations. Households have to believe in the integrity of the corporate structure: they need to believe that the managements of corporations are operating as fiduciaries with respect to the stockholders: are operating the enterprise in the interest of stockholders.

Some of the turbulence in Wall Street since the leveraged buy outs reflects a feeling that often business managements have been operating as not fiduciaries but in their own self interest.

In a simple structure we can conceptualize banks are restricted to short term lending operations securitized by goods in the production and distribution system where the cash to repay the banks will be forthcoming as these goods are sold: banks mainly lend to commerce rather than to industry. This restriction of bank assets guaranteed that cash flowed from the production system to the banking system and that the banking structure had to make new loans if the level of activity was to be sustained. This structure meant that banks did not participate in the financing of positions in capital assets except as the production of capital (investment) required financing. Households directly or in partnerships directly owned the capital stock of the economy.

In a commercial banking structure the financing of large scale investments and expensive capital assets requires that an investment banking community first structure, distribute and then provide for the trading of shares and bonds of corporations, the business organization form that is best suited for productions that require large scale, long lived capital assets. Thus one financial structure option is the capital market/commercial bank structure which still may be the Anglo American ideal.

The above structure has households owning stocks and bonds of individual companies. In United States today the significance of the private holder of corporate equities and bonds of large companies has decreased significantly. There has been a great democratization of the ownership of wealth, even though only a small percentage really own a significant amount of income earning wealth.[19] Most households that own wealth own it in the form of interests in funds, mutual, pension, money market, trust, and insurance reserves and these funds are the major holder of the liabilities of the largest companies. As a result of the vast accumulations in these funds a new type of financial capitalism has emerged. The managers of such funds are mainly interested in what has been called total returns, which are short term returns of dividends and the change in the values in the market of the securities. The various manias, from conglomeration to leveraged buy outs, that have swept capitalism in the past years have reflected the power of these funds. Let us call the 1990's version of the capital market/commercial bank financial structure money manager capitalism.

Two alternatives to the capital market commercial bank financial structure can be delineated, One is the Universal Bank and the second is the Public Holding Company. In the Universal bank structure equities of private firms are held in title or in trust by banks and households own bank liabilities, which may have the characteristics of money or be deposit certificates which are not immediately available. If households own equities in large companies these equities are often controlled as far as voting for directors and the

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19. Household wealth in the form of the accumulation of consumer goods and housing is ignored.

policing of management by the banks. In the public holding company model the equities of operating companies, which are formally organized as if they were private companies, are held by a public "holding company". The public holding companies finance their position by borrowing from banks, the market and grants from the Treasury.

The 1990's model of the capital market/commercial bank financial structure in the United States has a wide dispersion of claims to capital income - it may be called a peoples capitalism - but a large percent of the claimants to the income and the asset value of the liabilities of firms do not own any significant non-housing assets that are the direct liabilities of functioning economic units.

With the emerging dominance of the managed money funds in the United States there has been some convergence between the three models. This convergence is also reflected in the United States by a proliferation of government endorsements of private obligations.

THE OPTIONS

Because there is no significant private wealth the markets for financial instruments and the potential for market based financing is weak in the eastern world. The initial choice of a financial structure will be predominantly either the Universal Bank or the Holding Company model. As small scale service and artisan industry develop a start will be made on simple direct ownership that uses commercial type bank financing. As pension funds and private savings in mutual funds grow steps may well be taken towards the money manager type of capital market relations. But this will be possible only as the public holding company or universal bank model succeeds in generating firms with proven track records as far as profits are concerned. If the aim is to create a peoples capitalism using pension, life insurance and mutual investment funds then the transition from the inherited Socialism to a market economy may well be through the public holding company route rather than the Universal Bank.

Both the public holding company and the universal bank route are reflections of the thinness of the capital market in the countries where they are preeminent Germany and Italy. The need finance investment and to create manageable firms are main elements of the problem of transiting from socialism to capitalism. The simplest step is to first transform all enterprises into corporations and create a system of public holding companies in which national and local governments own the equity shares. The subsidiary companies are given directives to operate so as to make profits, although it is realized that in the absence of a history of meaningful prices periods of losses may ensue.

The holding companies will finance the investments of their subsidiary units bu issuing bonds, bonds that pay attractive rates and which carry government guarantees. The banks may be authorized to take some tranches of these bonds, and they will finance their position by issuing deposit certificates that are not immediately available cash. The workers will acquire vested pension rights by reductions from their wages, these pension funds will also purchase the liabilities of the holding companies. Mutual investment funds will be authorized on both national and provincial levels that will have in their portfolios not only the debts of the public holding companies but which will also be authorized to buy shares of private companies with profit records.

The public holding company is to be considered as a transitional device (the model is the Reconstruction Finance Corporation of Roosevelt's New Deal) but the transition will be rather long. The assets of the public holding companies are the equity shares of enterprises. As particular enterprises begin to make profits their equity shares will acquire value. The public holding company should slowly sell out its positions in these profitable companies, transforming them into private companies. The pace of privatization is ruled by the rate at which enterprises begin to generate believable profit flows and the rate at which the market for equity assets grow as individuals and funds acquire the ability to accumulate wealth.

The public holding company serves two purposes. It is flexible which means that it has the ability to adjust to changing market conditions and it makes for an orderly transition over a flexible time frame to a modern capitalist financial structure. Furthermore by allowing for local as well as national public holding companies it provides for the decentralization that will be the key to success.

As an extension transnational public holding companies should not be ruled out.

CONCLUSION

The transition

The transition to a market economy requires the construction of a financial system. The simple fact of the matter is that there is no private wealth and there are no effective price level for capital assets in the countries emerging from the Stalinist epoch. The practical device of public holding companies is a way to operate the economy as the necessary information for a capitalist economy is developed.

A question that hasn't been addressed is whether there is sufficient altruism and competence in the affected countries to operate public holding companies. To be honest we have to admit that the countries that are now emerging from the Stalinist model have never been very successful economies.

In the New Yorker Magazine of May 11, 1992 Lawrence Weschler: A Reporter at Large cites Jeffrey Sachs "Poland's biggest problem is the absolute inability to process good news." Sachs refers Weschler to Spain ... "the economic miracle of the past twenty years" ...In many ways, Poland's main task now is the same as Spain's was then - the return to Europe, the reintegration with this tremendous dynamo of the European economy. Sachs also cites Japan in 1947 and Germany in 1949 and 1950.

All of the countries cited by Sachs were capitalist countries that either were underdeveloped or which had just been beaten in a great war. Germany in the aftermath of the Second world war had all of the institutions of capitalism in place. The occupation and the Marshall plan were as much an institution building and reforming the financial system as they were aid mechanisms: the occupying authorities insisted upon the development of a United States type compartmentalized financial system in Germany and Japan. After the occupation they reverted to type.