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Assuming Clinton Wins

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Winning isn't everything, it only puts the burden on your shoulders.

1. Introduction

The election became a referendum on government economic activism and quite clearly activism won. The monetarist and supply side economics that inspired policy over the Reagan-Bush era was repudiated. The view that in our economy government has to intervene to assure that an adequate number of jobs exist and to advance a broadly defined national interest won. The returns show that the American people take the big claims of the efficacy of markets that conservatives advance with the proverbial grain of salt. Clinton won because when push comes to shove Americans prefer pragmaticism over ideologies.

This scepticism is also good economics. The financial excesses of the 1980's, and the poor way the resulting Savings and Loan and Commercial Bank failures were handled, means that the banking and financial apparatus we count on to finance American prosperity has been greatly weakened. Because of this the market reactions, which may operate to correct unemployment, will not take place. The same weakened financial system means that a generalized fiscal stimulus will not trigger a large burst of private investment.

Both the monetarist supply side and the standard Keynesian prescriptions will not work in the economy Bill Clinton inherits. While not forgetting the program put forth during the campaign Clinton has to recognize that the problem is more serious than anticiapted. The economic policy problem is not simply one of letting low interest rates work their magic or of a fiscal stimulus to increase aggregate, the policy problem is to create an improved job picture even as the financial system is transformed so that its ability to finance productive private investment is enhanced. Overhauling the financial system, will not bear fruit quickly in terms of jobs. As the jobs problem cannot be remedied by conventional monetary and fiscal means, the new adminsitration will have to adopt a non-conventional approach to reducing unemployment.

2. Financing Prosperity.

The main function of the financial system of a market economy is to facilitate capital development. Financing capital development involves exchanging money now for money later: the money later being earned as gross profits which are then distributed to the direct and indirect financiers in the form of dividends, interest and repayment of principle.

If the money now is spent upon productive and profitable investments, the private quest for capital income leads to an improvement in jobs and productivity. In this case the money specified in the future part of financial contracts will be forthcoming. If the money now is spent to finance speculation, in the form of take overs and the indebting of existing companies, after a brief period, during which speculation seems to pay off, the money for the future part of financial contracts will not come forth: these assets will not perform. Non performing assets compromise the equity base and the credibity of financial institutions. As a result the capital development of the economy slows down.

In the 1980's the mindless deregulation of financial institutions combined with an Administration, a Congress and a Federal Reserve that were oblivious of the changes that were taking place in financial markets tilted the balance in what was financed in favor of speculation. The speculative excesses, which need not be detailed here, led to an epidemic of non-performing assets in Savings and Loan Associations, Commercial Banks, Insurance Companies, mutual funds and pension funds.

Fortunately the excesses of the 1980's did not lead to a great collapse such as that of 1929-33. Deposit Insurance and Federal Reserve interventions contained the repercussions of the failures of financial institutions even as massive government deficits sustained profits. Nevertheless the capital of financial institutions was severely impaired.

The financial system is not now able and willing to finance enough private investment to achieve a close approximation to full employment. A substantial infusion of equity money into the financial system and the passage of time, during which the confidence of bankers recovers from the hits they took due to the poor performance of the assets they acquired in the 1980's, are needed before private financing of investment will generate a close approximation to full employment.

New and modified financial institutions are needed to expedite the process of overcoming the legacy of the 1980's and to meet the challenges of the 21st century. Two types of institutions that may well part of any financial restructuring are: Community Development Banks and Public Holding Companies.

1. Community Development Banks.

The number and variety of independent financing sources decreased over the past decade. A new set of banks, which emphasize Community Service and Development and which target smaller enterprises are needed to offset tyhe concentration of financial power which took place.

Community Service and Development Banks should have three departments. One department to provide payments services and secure assets, a second to originate and arrange for the financing of home mortgages and a third to act as a local "investment bank' for enterprises.

The first department will take savings deposits and deposits subject to check. The assets of this department will be restricted to Short Term Treasury and government guaranteed debts and the highest rated short term marketable private debt. As a result of the quality of the assets, deposits will be insured by the government. The face value of no other deposit will be guaranteed.

The Development Banks will be expected to make a profit from operating the payments mechanism. They will not be forced to clear at par: they would be allowed to charge up to 1% of face value for processing government checks and market determined fees for handling other checks.

A second department will specialize in mortgages on residential real estate. It will offer contingent value investments in packages of real estate: it will also package real estate mortgages for the market.

The third department be more of an an investment bank than a commercial bank. One aim of the Clinton administration should be to increase the number and variety of independent financing sources. The American financial system has lacked a wide spectrum of geographically dispersed investment banking institutions ever since Glass

Steagal seperated commercial and investment banking. Now that mutual funds have made the American asset owning population familiar with instruments whose value is not fixed but dependent upon the performance of assets in a portfolio, local investment banks which sell funds that specialize in local equity and debt instruments are feasible. The third department of the Community Developement and Service banks will provide investment bank services to local businessses and fund these activities with mutual fund like instruments.

IN the development banks all of the usual bank assets plus equity and long term debt and lease financing in companies will be funded by liabilities whose value depends upon the perfromance of the assets. To assure due dillegence in the financing relations as a minimum 105 of every fund sponsored by a Development Bank will be supplied by the banks own equity and the publically held instruments will be protected against a first 7 1/2 % decline in value by the bank's own investment. Unlike mutual fund investments the public's investment in these funds will be for a period of time, the period to be determined by the type of assets in the prtfolio. These rates on these liabilities 12:00 PM TUESDAY will need to to pay for a cadre of loan officers who will do the solicitation, structuring and supervising of those financied.

The equity and debt mutual funds would have have a 15% equity type investment: half from the sponsering bank and half from A Bank for Development Banks wjhich would act as both the central bank and supervising agency for these banks. The Community Bank and the bank for Development bank's Public holding Company's equity will take the first hits from a decline in asset values.

Each Community bank will have a well defined area from which it is to draw the assets of the Equity and Bond funds it manages. The aim should be to cover the entire country so that every potential business man is in the home territory of some Development Bank. The community bank will also be allowed to be an agent for national and regional mutual funds and insurance companies. The community banks would be a one stop asset store for the territory it serves: the charter of the community bank should require no account too small on either the asset or the liability side.

2. A Public Holding Company.

Ever since the second World War advanced technology projects have found funding from the military. The glory of route 128 in Massachusetts and Silicon Valley in California was due to our military budget. We need a peace time equivalent of the military financing of advanced Technology. The greatest and dominant United States export monopoly of the post war world, the Boeing 747, is a spin off of an Air Force competition for a giant cargo plane. We need a permanent government vehicle to sponsor not only advanced science research but also to fund the development of projects that would involve a private company's betting of the company.

The Development banks will need equity investment funds as well as participations in the various mutual funds that the development banks will sponsor and sell. Once again a vehicle for the government to participate in financing is needed. The manner in which we carried out the resolution of the negative net worth problem of S&L's and Commercial banks left us with an impaired capacity to finance enterprise.

The Clinton administration should work with the Congress to create a government holding company, modeled after the RFC, which can refinance companies and financial institutions which are in difficulty, help finance start up financial institutions which will offset the decline in independent financing sources during the past years, invest in technology development projects and participate in the financing of large scale projects which would otherwise involve betting the company. The sorry spectacle of McDonnell Douglas shopping the technology developed with the aid of Air force money to get a new generation of planes that could create a monopoly equivalent to that of the boeing 747 off the ground is evidence that something is missing in our financial structure.

I propose that the New model RFC start with an investment of 10 billions from the Treasury (being an Investment it neither increases government net debt nor government taxes) and an ability to use debt to lever the available funds to 25 billions.

3. A System of Project Oriented Government Funded Target Employers.

The forecast is that the private economy will not respond even to a substantial fiscal stimulus by increasing private investment. This means that the employment kick from a generalized increase in the fiscal deficit will not be large. The critical need is for jobs now, especially in the light of the decreased recruiting of personnel by the military. We might have a program in which the number of new recruits to the military is sustained but that these enlistments be short term basic training plus a term of working on preparing the military bases for civilian use.

Ultimately a full employment program comes down to the use of the government to supplement private employment by public financed work on desired and needed projects. However the necessary roads, bridges and other public works are not labor intensive and require skill mixes which are not in surplus supply. No matter how many times one turns the problem of creating a full employment economy around one comes down to the necessity of a works and youth oriented programs like the New Deal's NYA, CCC.and WPA.

These programs should be at or perhaps even below the minimum wage, they should be project based and should each target specific types of unemployed. IN the first instance NYA should be in school programs that would n\begin in junior high school and continue through graduate school. In part it will be a school aid program for it will pay for neglected aspects of schools: high school and college students as gym and recreational aids etc. \

The CCC was universally hailed as a success and it could be viewed as a supplement to the military undertaking useful functions within our society.

The WPA is the program that will replace welfare and extended job insurance and might well supplement Social security.

4. Conclusion

Bill Clinton inherits a gravely impaired economy. The situation is not as grave as it was for Franklin Roosevelt, but it has the two of the same ingredients: a greatly impaired financial system which needs restructuring and refocusing and a difficult employment situation in which private demands are insufficient to create conditions conducive to full employment. The situation Bill Clinton inherits is further compounded because a major prop to American prosperity and technological leadership, the spending by the military, the training in the military, and the support by the military of research and product development, will be pulled out as the post cold war world develops.

This situation also offers opportunities to Bill Clinton. Forthright facing the difficult situation, defining the agenda for change and inspiring discussion and even experimentation are some of his responsibilities over the next four years. He can turn the situation around, but not if he allows the conventional wisdom and the conventional definition of the problem to set the agenda.

In the past decade savings and loan associations and other financial institutions were hit very hard by non-performing assets. The result was the disappearance of a multitude of independent sources of finance and an increase in the average size and a compromising of the capital asset base of the surviving institutiona. This meant that the decentralized structure of financing for new and expanding business that characterised the American economy throughout its history shrunk.