

11-17-1992

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Recommended Citation

Minsky, Hyman P. Ph.D., "The Meaning of Clinton's Victory" (1992). *Hyman P. Minsky Archive*. Paper 171.
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The Meaning of Clinton's Victory

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Prepared for Presentation at Libero Istituto
Universitario Carlo Cattaneo, Castellanza Italy
November 17, 1992

The political background for the next period from Clinton's (Democratic) perspective:

Republican party is split among factions.

There is a good chance that Clinton can bring the remnants of the liberal Republicans (The country club Republicans) to a broad Democratic coalition.

The racist slant among Republicans.

The surprisingly large number of Perot supporters (19% of the voters) are up for grabs:

Clinton has already thrown them a bone by the ethics code he intends to issue.

He can use the Perot vote to gain flexibility on tax issues. In particular I can visualize a gasoline tax and a revival of a traditional Democratic position supporting a tariff for revenue.

Clinton is by nature a negotiator.

He is unlikely to take advice from one position only.

He will try to diffuse the ideological content of the economic policy debate.

A period of relative prosperity beginning in the third year of Clinton's term should lead to his reelection.

Being a consummate politician he will aim at achieving that.

He therefor has two years

1. SOCIAL ISSUES AND ECONOMIC ISSUES

There is room for White House initiatives on social issues.

Clinton has already indicated that he will undo the infamous Bush ruling on abortion counseling.

2. Economic Issues usually require Legislative Action.

Expect some administrative decisions on regulation and the environment.

The "tough" tariff action re common market is a precedent for Clinton.

For the next year or so Clinton cannot be softer than Bush on protecting American export and farm industry.

Expect some action on rice and Japan and Korea etc.

Reich an advocate of Managed Trade: so is Krugman

Shakespeare summed up the problem of economic policy when he had Portia say

"If to do
were as easy
as to know what were good to do,
chapels had been churches,
and poor men's cottages
Prince's palaces.

Clinton's style will be negotiation, Bushes style was confrontation.

2. THE PROBLEM OF DIAGNOSIS:

Almost all of the rich capitalist economies seem to be suffering from a lethargy, a tiredness.

The problems of the economy, while not of a life threatening nature as they were in the 1930's, seem not to respond to the usual policies.

There seems to be some common elements in the economic problems that rich countries now face.

My hypothesis is that this common economic lethargy is due to three factors which are present, in different degrees, in all of the countries:

1. Overindebtedness - both public and private - and a resulting fragility of the financial structure.
2. Fiscal imprudence, chronic government deficits and
3. A need to rethink the welfare state dimensions of the policy mix: all are reluctant to test these waters.

3. THE SHADOW OF FRANKLIN ROOSEVELT

Let us say we were having a dinner like this one sixty years ago. Franklin Roosevelt had just been elected President after 12 years of Republican rule.

At that time

the problems of the economy were threatening the life of capitalism:

Hitler would take power in Germany before Roosevelt was inaugurated, (The long interregnums in the United States) Socialism and corporate capitalism were realistic threats.

The Marxist prediction, that Capitalism would generate a sequence of deeper and longer depressions interrupted by short uneven prosperities until the system broke down into incoherence, could not be contradicted by the evidence available at that time.

There was nothing in Roosevelt's background that would lead one to believe that he would preside over a "Revolution" that would revitalize democratic Capitalism.

4. MARXISM REFUTED

Beginning from the end of World War II and the rebuilding of Europe and Japan the course of history discredited the Marxist prediction.

Roosevelt ended up reconstructing the American Economy along a different model than that which had dominated the American scene over the period in which industrial capitalism replaced a largely agrarian society.

Economic growth that improved the lot of those at the bottom of the income distribution as well as the middle and the top was the norm from the late 1940's until almost yesterday. Shortfalls from this growth were brief and mild.

Capitalism which was a dismal failure in the winter of 1932-33 was a success for most of the period since 1948.

However the Capitalisms that were successful in the United States and the rest of the "rich" capitalist economies followed a model that was different from the largely laissez faire capitalism that had failed.

5. SUCCESSFUL CAPITALISM

Call it whatever you wish, the welfare state, the Social Market Economy, the Scandinavian model, The Keynesian model or big government interventionist capitalism, the successful capitalisms after World War II involved positive government policies to foster employment, technological development and social minimums.

It is that model which is under attack: Thatcher, Reagan repeal and repudiate, Clinton modify, respond to the pressures of the times.

6. THE SPECIAL UNITED STATES MODEL

In the United States big government capitalism took a special turn.

The cold war - along with the hot wars in Korea and Viet Namm - skewed the America towards military production.

Even the greatest American international trade coup of the post war era, the Boeing 747, is a civilian spin off of a design for a long range military transport that lost in the military competition.

America's post-war industrial development was heavily influenced by the military.

The military drained a great amount of scientific, engineering and entrepreneurial talent from civilian pursuits: the military industrial complex of which President Eisenhower warned ruled the roost.

The fall of the Soviet Empire, perhaps hastened when Reagan raised the stakes in the Cold War poker game, deflated the value of the military industrial complex.

(Can even think of this as a revolutionary obsolescence of a the productive capacity of the American economy.)

The United States is now confronted with a need to redeploy its scientific, engineering and industrial talents: to create a civilian economy that not only achieves and sustains a close approximation to full employment but is fully competitive in the world markets.

The situation is equivalent to a demobilization after a great war. We handled the demobilization after World War II well. We rolled out the money in great wads, we

practically gave the industrial plant created for the war to private firms (privatization by gift)

In the United States - and in the rest of the capitalist world a vast expansion of debt, public and private, took place over the 1980's.

A strange alchemy, which valued a business prospect more if it was highly indebted than if it was conservatively financed, became the order of the day.

7. THE FINANCIAL DIMENSION

About five years ago an epidemic of non-performing assets hit the "banks" that specialized in home financing.

This was followed by an epidemic of non-performing assets and a string of overt and covert failures and near failures of large and even giant banks.

The precarious position of the financial institutions did not lead to a debt deflation, the process which leads to a deep and long depression, because government agencies intervened in one way or another to prevent the pass through of the downward revaluation of financial assets from leading to a decline in the market value of bank deposits.

This "no pass through of losses on assets to holders of liabilities of banks etc." is one reason the current situation is not as serious as that of 1932-33.

However many of the institutions that have taken losses on their assets have failed, as have many highly indebted firms. The process of failure and rebirth, with a new liability structure, is still not finished.

President Clinton will try a fiscal stimulus.

Because of the weakness of the private financial institutions we cannot expect a burst of private debt financed spending to take off after a fiscal stimulus raises demand and profits.

The result from fiscal expansion is likely to be disappointing, especially if it is a tax reduction.

It is best if the fiscal expansion take the form of government spending. At least the value of the output produced by the fiscal expansion is added to GDP.

The fiscal expansion would be best if it took the form of a a longer range program of investment in infrastructure

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8. THE FISCAL-DEBT BLOCK

Even as President Reagan stepped up spending on military systems of various kinds his political ideology and the temper of the times led to a reduction in tax rates.

The attempt to cut civilian spending failed.

The belief that tax relief and deregulation (supply side economics) would spur an accelerated real growth was falsified by history.

The GDP growth was heavily due to the explosion of financial services, not by real productivity.

The loss of consumer goods and capital goods markets by American firms in the 1980's was evidence that something was wrong.

The Free market ideology of the Reagan - Bush teams blinded their vision.

The Federal government debt grew from being about 1/3 of GDP when Reagan was inaugurated to being 2/3 of GDP when Clinton takes office.

It is a political necessity for Clinton to reduce the ratio of debt to GDP, without resort to an acceleration of inflation, during the next two years.

9. THE DRAG ON THE 90'S

The American economy is not suffering just a transitory decline in aggregated demand which can be offset by a traditional expansionary monetary or fiscal policy which triggers an expansion based upon private investment privately financed.

The institutions of the financial structure which have just taken "large losses" will not jump in and finance

investment.

As a minimum these institutions need several years to regain their courage.

Clinton endorsed Community Banking in his campaign document. A network of smaller local banks that serve and help develop their neighborhood. These small banks encouraged to act as investment and merchant banks as well as American style limited banks.

The idea is to "bubble up from below" rather than trickle down from above.

Fund entrepreneurship at the small local level.

The problem here is that even if Clinton can get action on the small Community bank idea it takes many years before the benefits will be visible.

10. THE QUICKER FIX

Clinton will be forced into a quicker visibility program. The direct employment devises of the New Deal. Jobs for youth in a conservation corps, jobs for others in a works program at the local level.

11. THE ENEMY WITHIN

Twelve years of Republican appointees to the Federal Reserve Board and the Presidencies of the Federal Reserve banks.

Ideologues of a monetarist, supply side faith in these positions of power.

If Clinton's fiscal expansion leads to a rise in the deficit or even a modest increase in the price level the FED will jump into a "fighting inflation mode"

Monetarist thinking: if expansion leads to a rise in the money supply monetarists translate this into inflation tomorrow. They jump into an anti inflation mode of operation and frustrate expansion by monetary constraint.

12. THE SERIOUS LONGER PROBLEMS.

1. Medical care structure
2. Pension Funds
3. Education
4. The aging population

13. THE REALITY

The United States is a very rich country.

Its GDP is about \$6,000 billions.

It is lightly taxed.

Its institutions of higher education its research Universities are the best in the world.

It is in a dominant position in medical research.

It is the most open to immigration of any rich country.

These are among the realities that Clinton has to deal with.

Given the obtuseness of government over the past 24 years the United States is surprisingly strong.

My personal view:

If Clinton would substitute full employment for economic growth as the main objective of policy, the result would be a broadly distributed prosperity in a revitalized American economy.

A final remark: The past twelve years gave us policy derived from ideology. Clinton should see a return to pragmatism as the guide to policy making.