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Yes, There is a Democratic Economics

Hyman P. Minsky Ph.D.

YES, THERE IS A DEMOCRATIC ECONOMICS[1]

Hyman P. Minsky

The Jerome Levy Economics Institute
Bard College
Annandale on Hudson, NY

A little history may be the best place to begin an argument to the effect that there is a Democratic economics that is far different than Repulican economics. The difference between Democratic and Republican economics resonates with differences among economists as to the nature and significance of economic theory and the way history or experience is read.

Republican economics views the market way of doing things as allocating given resources among alternative employments: the market mechanism generates an equilibrium which in some sense is a best. This view is based on a misinterpretation of the content of modern theoretical economics embodies and ignores the long history of economic system malfunctioning. In particular Republican economics ignores the impact of the economy's complex financial structure upon system performance. The economc theory which underlies the Republican model of the economy has no place for money and finance in the determination of system

1. The taking off point for this paper is the article "Is There a Democratic Economics?" by Robert Kuttner in The American Prospect, Winter 1992 issue.

performance. Business cycles are not integrated into the Repulican view of the world: this means that the Great Depression as well as then earlier extended periods of depression are explained away. Aside from the need to protect clients, Republican economics accepts the wisdom of laissez-faire as the guide to policy.

Democratic economics views the market way of doing things as a mechanism for financing investment and positions in capital assets: the economy is a complex mechanism that links yesterday's and tomorrows to todays. These links are not just the capital stock and the labor force but also the a structure of prior commitments of income which is embodied in the financial structure. Because their complex linkages through time cannot be well described by "linear" relations, capitalist economies can run out of control. Running out of control, where the reaction of units to being in a not desired state increases dissonance i.e. makes an initial situation worse, is an apt description of what happoned in the 1929-1933 period and what happens in serious inflations and deep deperessions. Democratic economics views capitalism much as Churchill is supposed to have viewed Democracy: the worse of all possible economic systems until one contemplates the alternatives.

Capitalism was a failed economic system in 1933 - in its own way as dismal a failure as Communism is in 1992. When Franklin Delano Roosevelt was inaugurated the financial system was bankrupt, industry was in disarray, agriculture was in revolt and, for many, gainful employment was a distant memory. A contraction which began in late 1929 had set off a series of amplifying reactions so that chaotic was the best one word description of the state of the nation an inauguration day. An unprecidented collapse of financial institutions and asset values as well as an enormous decline in employment, prices and wages.

Poverty had always characterized capitalism: As Abraham Lincoln remarked God must have loved the poor, he made so many of them, but the extent was bloated by the economic crisis. Whereas throughout history poverty had been a supply side phenomena, the capacity to produce was insufficient to provide abundance, in the 1930's poverty was exploding "..in the midst of the ability to produce plenty" Even after the recovery was under way, one third of the nation was ill housed, ill fed and ill clothed.

The dismal situation in the United States was replicated in the other advanced capitalist countries. Orwell's Wiggan Pier and Steinbeck's Grapes of Wrath testify to the failure of capitalism. The failure of capitalism in Germany was a prelude to Hitler's rise to power.

An unprecedented wave of reforms and interventions followed Roosevelt's inauguration. The aim of these reforms was to facilitate recovery and to create a capitalism that would not be subject to great contractiona and which incidently would do something about the disasterous disparaties in incomes, wealth and power.

Recovery and reform were often in conflict. We now know that one reason the recovery was not realized until rearmament became the order of the day in 1939 was that the fiscal stimulus was too small, but the Keynesian framework of ideas that make fiscal policy a determinent of the national income was not put together until Roosevelt's first term was comong to an end.[2]

In a large measure the New Deal created a capitalism which was not subjected to the extreme cyclical instability of the pre World war 2 era and diminished then greates disparities in income distribution. In the 1950's and 60's a closer approximation to peacetime full employment was achieved and sustained than ever before. Furthermore the benefits of this prolonged prosperity were widely distributed throughout the population. By the mid 1960's it seemed as if the major battles against poverty had already been won: Johnson's war on poverty was more of a mop up operation than a critical engagement.

The capitalism that succeded differed in essential ways from the capitalism that had failed. Laissez faire and small government characterized the failed capitalism. Intervention and regulation along with big government characterize the successful capitalism.

Economic stresses and strains have now surfaced in the United States as well as in other successful capitalist economies. The normal evolution of economic institutions

2 Keynes' General theory was published in Britain in February of 1936, three years into the New Deal.

and the rise of political forces which do not accept the fragility of successful capitalism have undermined some of the foundations of the success. Poverty has been resilient. It survived the war against it and is now winning battles.

Evolution has taken a toll of some of the institutions of successful capitalism. Features of American capitalism during its most successful era, such as strong and responsible trade unions and highly localized and narrowly focused Savings and Loan Associations, have diminished in importance. The compartmentalized financial system that was put in place in the 1930's fostered enterprise and investment. Institutional evolution, such as the rise of pension funds, legislated changes, such as those which broadened the asset base for Savings and Loans, and policy errors, such as the monetarism of the 1980's, transformed the financial system into an engine for speculation. The speculative excesses of the 1980's left us with a financial structure that requires continued massive infusions of government funds to prevent the chaos inducing debt deflation of the 1930's from being replicated in the 1990's. Ignorance, complacency and venality seem to be bringing the age of successful capitalism to a close.

A most pernicious change occurred in economic thought during the years of capitalism's success. The critical and skeptical veins of economic thought, which emphasize the conditionality of successful capitalism and whose theoretical structure leads to the proposition that intervention and big government are necessary for successful capitalism, were virtually banished from the academy. Even as the technical proficiency of economists increased, economic theory has been reduced to the mouthing of vacuous phrases such as "The market knows best", "Money matters" and "There is no such thing as a free lunch".

Over the era of successful capitalism, mainstream economic theory lost touch with reality. When the economic theory that inspires economic policy becomes irrelevant, then the economy is on "The Road to Disaster". This happened in the Soviet Union and can happen in the United States.

However capitalism is not frozen in concrete the way Soviet Socialism was. One of capitalism's virtues is that it can take many forms. As one form breaks down another form can be developed and put in its place.

A new model of capitalism is needed for America to achieve once again the broad based success that we enjoyed in the 1950's and 60's. The development of the structures of a new model capitalism requires an understanding of how a successful capitalism is transformed into a failed capitalism. This understanding is what an economic theory which focuses upon the dynamics of a capitalist economy can provide. We have to use a model of the economy in which a financially complex market economy can be reduced to chaos, as happened some 59 years ago and has been threatened in recent years, as the guide to reconstructing the economy.

"The only thing we have to fear is fear itself" was Roosevelt's clarion call on inauguration day. It expressed a will to replace chaos with order, to create and sustain an approximation to full employment, and to set the country on a road which did not lead to a quick repeat of the 1929-33 debacle. This required changing institutions. The New Deal reformed financial usages, increased resource utilization, fostered resource creation and placed barriers in the way of downward price flexibility.

There was very little in the way of income maintenance by transfer payments in the New Deal. The principle was that income was to be maintained by work. The welfare state, defined as a system of transfer payments, such as aid to families with dependent children, and as a provider of services, such as medicare and medicaid, was not a critical part of the New Deal.

Financial reforms eliminated the gold standard constraints upon the Federal Reserve, insured deposits, compartmentalized banking by dividing banking functions among specialized institutions, provided for closer regulation and examination of banks, financial institutions, and financial markets and inaugurated transparency as the rule in corporate finance and financial markets.

Resource utilization was promoted by direct employment provided by The Civilian Conservation Corps, the National Youth Administration and the Works Progress Administration. Resource creation took many forms: public works, rural electrification, TVA and other river harnessing projects, the tree belt, reforestation and public housing. In part, resource creation and financial reforms were combined: the long term fully amortized home mortgage was closely tied into the creation of housing and the development of a nation of home owners.

Furthermore, the Reconstruction Finance Corporation invested in enterprises as well as in banks. Barriers against a free fall in the price level included agriculture price supports, minimum wages and government support of trade unions.

It should be noted that CCC, WPA, and NYA were project oriented: only in the emergency start up phase were approved projects of an obvious made-work nature. The labor force was taken as it was. Projects were designed to use existing abilities. A dole was anathema: income from work was to be available to all who were willing and able to work.

Aspects of the current situation resonate with the Hoover years. Once again the official economists intone "Prosperity is just around the corner". Once again gimmicks, such as the "middle class tax cut", are put forth as devices to bring prosperity back. Once again others - this time the Japanese - are held responsible for our ills. Once again an excruciating waste of human beings is tolerated.

Of course the economic situation is not as dire as it was 1933. American capitalism is not the thoroughly discredited chaotic system it was in March of 1933. The economy is floundering, it is not yet a disaster. Our majorroblems may be social and not economic, but an economic policy that provides a close approximation to full employment is a tool for getting a handle on our social problems. America's leaders, Republican and Democrat alike, are like Hoover: they fear to act because they do not understand what is happening. What the United States needs is a New New Deal.

A successful economy fully uses its resources and creates resources. It achieves and sustains a close approximation to full employment. Its ability to produce grows as a by product to sustained full employment. In the aftermath of the second world war the big government welfare and armament state provided a close approximation to full employment. A vigorous creation of both physical capital assets and an educated population took place.

The only legacy of the New Deal that has grown in recent years is the transfer payments system. In particular the income maintenance system, which is anathema to the principles of the New Deal, has, by means of aid to families with dependent children, created a dole dependent population.

Social Security, which is a continuing success, is endangered because it has not been adjusted to allow for increases in life expectancy. In a full employment world, where a WPA backs up private demand for labor, we could quickly move to 70 as the age of retirement. With 70 as the retirement age the wonders of compound interest and of an expanded labor force will enable the country to afford the costs of an improved Social Security system as well as a universal medical care system that is not means tested.

As the twenty first century approaches, we should not think of putting an exact replica of the CCC, WPA and NYA of the 1930's in place. The details of a permanent program that makes income from work available to all will certainly be different than the often improvised programs of the 1930's. But it is rather foolish not to accept that which worked in our past as a guide to economic policy for our future. We should learn from our history: the Federal government must become the guarantor of full employment and a partner of private enterprise in the creation of resources.

As a starter to the debate I suggest that the Economics of Democrats includes:

As a minimum the agenda for a New New Deal should include:

1) Devices that decrease the dependence on transfer payments for those fit to work. In a humane society this can only be done if access to income from work is available to all. We should not think of simply replicating the 1930's CCC, NYA and WPA: these 1930's mechanisms can best serve as prototypes.

2). Greater Federal government financing of infrastructure investments and the creation of National research universities and institutes.

3). A reconstituted banking and financial system which emphasizes community banks and which will finance the capital development of the country and not dissipate its resources in financing speculation.

4). A new Reconstruction Finance Corporation to recapitalize financial institutions and to assure that adequate financing is available for viable projects.

5). A universal access health system and vested defined contribution pension systems to supplement social security. The job related health care and pension systems are obsolete in today's competitive environment.

6.) A tax system that equitably finances government and is balanced at full employment.

In 1933 it was the genius of Franklin Roosevelt to recognize that we, the people of the United States, were not resource constrained. The disaster of 1929-33 was due to a failure of will and to the blinders which wedded policy to laissez faire. The requirements for turning the country around in 1992 are the same as they were in 1933: a recognition that we are not resource constrained and the will to throw off the conservative ideology that has done such a disservice to our country.

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