A Positive Program for Successful Capitalism

Hyman P. Minsky
The Jerome Levy Economics Institute

As we celebrated the fiftieth anniversary of the end of World War II, we should have paused and also celebrated a significant non event of the era since World War II: a non event which frames our economic and social policy discourse. This non event is a depression, which by not happening made capitalism a success. It was the successful capitalism of the post World War II era, and not some abstract market economy, that secured the victory in the cold war and "buried communism".

This successful capitalism does not conform to the laissez faire model which is inscribed in textbooks and serves as the core of the "training" of professional economists. The successful capitalism of the post World War II era was and remains an interventionist capitalism. It has a big government at its center and, for the earliest and most successful part of the era, a central bank that was not encumbered by a need to be concerned about the status or value of its currency in international markets.

Sustained prosperity in the United States, combined with the dominant international financial position of the dollar, allowed, through an open door to imports and

1. This title consiously echos Henry Simons A Positive Program for Laissez Faire.
transfers such as the Marshall Plan, for American prosperity to spill over to both Western Europe and Japan. The United States' international position was so dominant in the beginning of this era that even after Europe and Japan achieved a prosperity that was commensurate with the prosperity of the United States, the United States was able to continue to run huge deficits in trade which powered the expansion of a second tier of countries: Hong Kong, Korea, Singapore and Taiwan.

The no depression capitalism of these last fifty years has led to the fragility of good times and the prevelance of hard times of the small government essentially laissez faire capitalisms that ruled prior to World War II, to fade from the collective memory of our society. The dominant strain of economic teaching and what passes for thinking about economic policy these days takes "no depression capitalism" as the norm.

The invisible hand assertion of Adam Smith, cite has been accepted as the foundation for economic policy. The assumption of "no depression capitalism" is propped up by what are taken to be the results of mathematical economics. It is widely believed by the on the whole poorly educated professional economist of the United States that the mathematical general equilibrium theory shows that a decentralized market economy leads to an outcome that can be labeled an optimum. However the best that the mathematical
economics can do is take the initial distribution of wealth as sacrosanct and that all agents in the economy have perfect foresight.

If economic agents are like the physicist Richard Feynman's scientist

"The scientist has a lot of experience with ignorance and doubt and uncertainty ... we take it for granted that it is perfectly consistent to be unsure."²

they not only have imperfect foresight but they know they have imperfect foresight then the equilibrium, to which the invisible hand is supposed to guide the economy, does not exist. In an economic world in which equilibrium does not exist economics of necessity must deal with processes that generate the path through time of the economy.

An economic world without equilibrium is one in which periods of tranquil behavior (pseudo equilibrium) give way, because of the internal structure of the processes that determine the interdependend system's path through calender time, to explosive, implosive or hysteretic behavior. Such an economy needs systems of constraints and controls which contain the incoherent behavior and set the econmny into a new regime of transitory tranquility. During these episodes of transitory tranquility the economy seems to achieve a semblance of the smooth behavior that could be passed off as an equilibrium, but it is a pseudo equilibrium because it is

---

mainly the results of effective constraints and interventions. Note that such pseudo equilibria are conducive to risk taking and investing. As will be argued later effective interventions, which sustain a close approximation of full employment, are more certain guarantors of future gross profits than the invisible hand postulated by economic theorists.

The successful propaganda for the benefit of those who do well under controlled capitalism, by economists who do well by catering to those who can pay for such advisers, has led the public as well as our policy makers to accept the superiority of the laissez faire model of capitalism to the interventionist model. The fact that a economic structure and policy regime that was a close approximation of laissez faire broke down over 1929-33 and the very imperfect interventionist regime, whose contours had been largely set in place during 1933-1937, enjoyed unprecedented success over the first 20 to 25 years after World War II was made obscure by a chorus orchestrated by those who, inspite of doing well, were disaffected by the level of taxation required by a successful big government capitalism if it was to maintain the validity in the market of its debts.

Thus policy making as we approach the end of the 20th century rests on false premises: an unwillingness to recognize the historical fact that the capitalism that ruled after World War II was superior to the capitalisms of earlier times.
For the United States this no Depression capitalism that ruled over the fifty years since World War II is especially striking when compared with the behavior of the American economy over the 75 years that elapsed from the end of the Civil War to the start of World War II. The Great Depression, which began in 1929, hit bottom in 1933 and still ruled until the massive fiscal impact of World War II brought prosperity, was just the biggest of the regular progression of hard times, rainy days and depressions that characterized the path of the American economy as it industrialized.

Even as 1995 is the 50th anniversary of the end of World War II so 1996 is the 100th anniversary of William Jennings Bryan's Cross of Gold speach to the Democratic Party convention. In that speach Bryan articulated the frustration of the American workers and farmers over the run of crunching depressions that had taken place over the 30 years since the end of the Civil War. The depressions against which Bryan railed were followed by depressions in 1907-8, 1921-22, the big one of 1929-33 and a final pre World War II depression of 1937-38. No depression of comparable depth or intensity to those of the first forty years of the 20th century has occurred since 1940.

Something that was wrong in the earlier American Capitalism was missing in the post World War II American capitalism: this something was the inability of the Federal Government to contain and offset the tendency of our
capitalism to deteriorate into serious depressions. There are two candidates for what is better between 1945 and 1995 which was not there between 1865 and 1940. One is the immensely larger share of the federal government in the economy. This larger government sustains profits through its deficits, which occur when private investment falters and when as a consequence, income falls away from a high and growing level.

The second is the way in which the stability of the banking and financial system has been enhanced by a combination of

1. central banking that is not constrained by gold standard rules,
2. the contractual requirement for deposit insurance, and the Federal government as the guarantor of deposit insurance, to infuse implicit or explicit equity into negative net worth depository institutions, and
3. the sustaining of the prices of financial assets by a combination of the Central bank intervention into financial markets and the aforementioned manner in which government deficits sustain aggregate profits when private market determinants of aggregate profits would lead to a fall in aggregate profits.

Both the increase size of the government and the greater ability to stabilize financial markets are improvements in the control mechanisms for the economy which contain the downside potential of the economy over the
control mechanisms of the earlier forms of capitalism in the United States. Government tax and spending policies, which turn from surpluses towards deficits whenever the economy contracts and from deficits to smaller deficits or surpluses whenever price inflation rears its head, has the power to contain both depressing and inflationary potentials of our economy.

The impact of the increased share of government in preventing depressions follows from the way government deficits sustain and even increase business profits whenever private investment, the dominant source of profits in a small government economy, turns down. Financed investment spending sets in motion activities that force savings and profits out of a small government capitalist economy. If the Federal Government had been significantly smaller in relation to the economy than it is now, say we had a Federal Government that was 3% of Gross product, as it was in 1929, rather than a government that was about 25% of Gross product, as it was during 1988-1992, then the mild recession at the end of the Bush administration would have been a major depression. It was big government that saved President George Bush from going down in history as a second President Herbert Hoover.

In the absence of the government which runs large deficits, a decline in investment and profits, in the context of a fragile financial structure such as we had in the late 1980's, would trigger a recursive debt deflation
process by which an intensely financial market economy collapses into a deep depression. Government interventions stabilize the economy by stabilizing profits. With profits sustained a collapse of income, employment, output prices, investment and asset values does not occur.

It is not necessary for Government to be as big as it is now to be effective in containing depressions: a government that is 20% of Gross product would do, especially if tax and spending programs were such that a small fall in income and employment would lead quickly to a deficit large enough to sustain profits. For this to happen government revenues would need to decrease markedly and government spending would need to increase sharply when income falls. This implies that the tax system would need to be very progressive.

A government that is somewhat smaller than our present government, one that is say 20% of gross product, needs to have a tax system that collects a tad more than 20% of gross product during good years even as it runs deficits in poor years. But a tax system that collects some 20% of gross product in taxes bites into the incomes and the purchasing power of the public. Such biting taxes mean that there is a constant danger of a tax revolt, especially if the public is unaware of the relation between the size of government and the well being of the economy.

Government debt is unlike private debt only in that government has a longer expected survival time any private
debtor. In history government debt has often fallen into bad repute: the phrase "Not worth a Continental" refers to the worth of the debt of the Continental Congress in the interval between the Washington's victory at Yorktown and the birth of the Constitutional Republic. The worth of government debt, like the worth of any debt, depends upon the cash receipts of the debtor. The credit card debts of most people, and the debts of the credit card issuers on the markets largely depend for their value upon the mainly wage and salary incomes of the card holders. The value of bonds and stocks of businesses depend upon the gross profits that enterprises earn. The value of government debts depend upon the ability of the government to collect taxes.

The implication I draw from on the one hand the necessity of government to be big and on the other hand that the tax system this government needs, in order to maintain the acceptability of its debt in bad times, has to yield so much in revenue that there is always a threat of a "taxpayer's revolt". It behooves those who recognize the fragility of capitalist success and its dependence upon government being big to propose tax systems which are adjudged to be fair and spending programs which yield benefits that are wide spread and deemed to be worthy. Those who are aware of the importance of big government to successful capitalism need to forever be questioning the wisdom and the aptness of the taxing and spending policies in place.
Every tax system has a structure. Every spending program has a structure. A tax system put in place over the past fifty years can now have different impacts than it had when it started. A great deal of the tax and the spending programs in place have their origins in the measures undertaken to overcome the great depression of the 1930’s. Such measures initially put in place in the effort to recover from the great depression have been adjusted and revised through the years. In their present form and in the light of a capitalism which has not had a serious depression for half a century they may not be appropriate.

No institutional structure will be efficient forever in a world where the restrictions of the institutional structure constrain self interest driven behavior. There is a propensity to evade and avoid restrictions just as there are propensities to evade and avoid taxes. The Jefferson idea of a need for a revolution every 20 years has merit. However the revolution need not be a dumbing down of the society which is the characteristic of the Republican Conservative "Pseudo Revolution". We must not forget that a core of the neoconservatives consists of former Troostskists and their Red diaper babies: Once a Leninist always a Leninist.

Two pronged tax reform Consumption based tax and value added tax.

Pro progressive consumption based "income tax" Tax what one takes out rather than what one puts in.
Defining what one takes out: fair rental value of owner occupied homes. This is the biggest loophole in all of our tax laws. The deductability of all payments on mortgages, not just the interest.

Capital gains tax as selective: pension funds capital gains are not taxed - the incomes of the pension receivers are taxed and there is no distinction between what part of the income is due to interest and dividends and what part is due. Essentially treats self managed assets as equivalent to fund managed assets.

Value added tax: We now have a partial value added tax. 
VA = VA labor + VA by capital

Employers contribution to social security = % (va by labor) + 0 (va by capital) 
whereas 
VAT = (VA Labor + VA capital) %
split VA payments into SS % (VALabor) and (1-ss%) (VALabor) and add % VA (Capital)

Dominici - Nunn: The emergence of a Serious Alternative to the our current Income Tax.

The current griping about the poor performance of the economy reflects the fact that the first period after World War II, 1945-1970 was markedly better than the second post war period, 1970-1994. This deterioration while serious, is minor compared to the mass impoverazation that took place say between 1929 and 1933.

Large government combined with the need for fiscal responsibility, which requires that government debt does not increase as a ratio to national income over a run of years means that the tax system must. The proposal by Senators Domenici and Nunn to shift to a combination of progressive personal consumption tax and a value added tax from our current combination of a progressive personal income tax and a corporate income tax elevates the seriousness of the discussion of tax reform.