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The Global Economy: The Vision from the North

Hyman P. Minsky Ph.D.

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Hyman P. Minsky
Professor of Economics
Washington University
St Louis Mo. 63130 USA

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The title of my talk was assigned by our conference chairman before the great changes of the past three months. I doubt if anyone would readily take up such an assignment today.

The events of the last several months in Eastern Europe have thrown a mass of broken trajectories and new initial conditions into any attempt to assess where we, the units in a global economy, are and to project a vision of the future. How can we have a vision, which implies a forward look, when we know not where we really are and we know not the import of the new conditions? This is especially so if your fundamental theory argues that the dynamics of complex economies are dependent upon both the trajectory and the initial conditions: for much of the world the trajectory has been broken and the new initial conditions are not in place.

But I will be brave and go forth into the fray. I will apply a post Keynesian perspective, which integrates financial and real aspects of capitalist economies, to summarize some problems that the global economy faces and what these imply for the semi-industrialized economies, particularly those of Latin America.

Even as I announce this program I recognize that what I will project is most tentative. No doubt I will alter my views in the course of this week.

The recent events in Panama imply that the freedom of action of Latin American countries is constrained. (The New York Times of January 8th carries assurances from the State Department that the intervention in Panama is not a precedent for intervention in other Latin American countries. Being from Missouri I have my doubts about the validity of the promise) Thatcher's Falkland adventure showed that even a weak modern military power such as Britain can project power over great distances. Britain's military power is infinitesimal in comparison to that of the United States. This implies that the domestic economic and social policies in Latin American countries that aim to "get their countries moving again" cannot too greatly affront the men of little vision who govern the United States and command great military power even as their economic power has been much weakened. The memory of Vietnam is no longer an effective constraint upon United States intervention and adventuring, especially in Latin America.

One implication of the above is that any economic program for vitalizing the semi-industrialized economies of Latin America must be capitalist in nature. Fortunately capitalism comes in many flavors, so that a wide variety of economic programs can be labeled pro-capitalist.

I personally do not like the limitations upon what can be contemplated that the above implies. But economists are used to working with constrained maxima and the limitations set by the Big Brother to the North set the constraints for what can be done. It is best if programs of recovery and expansion be labeled supply side.

By semi-industrialized countries we mean those economies which have modern industrialized sectors but which also have great pockets of backwardness and even of traditional ways of life. The economies of Latin America that have been experiencing reductions in their ability to produce as a result of the depressions induced by international indebtedness are semi-industrial, as are some of the Asian export platforms like Taiwan and Thailand. India, The Phillipines, and the Moslem countries of the Mediterranian basin are not sufficiently industrialized to be considered semi-industrialized.

Now that the countries of Eastern Europe are at least candidate members for the global economy the list of semi-industrialized countries needs to be expanded. I will boldly state a theme: from the theoretical perspective that I use the problems of assimilating the countries of Eastern Europe to the global economy and of revitalizing the semi industrialized economies of Latin America are similar. The progress of both sets of countries - recognizing that there are great differences within each set - depends upon constructing a financial structure that can 'force' a surplus and 'direct' the surplus into productive channels.

One aspect of the semi-industrialized status is that for a wide variety of development projects, capital asset creation and education projects "autarchic" development is fasable. One initial condition for the Latin American countries is the overhang of dollar indebtedness and the effective closure of the international financial markets to Latin American instuments. Thus "autarchic" development is the only possible way.

Inept and inefficient allocations of at least some of the surplus are common to all economies. The Soviet style economies broke down because the surplus extracted over the last part of the post war period did not lead to an appreciable increase in productive power and goods available for consumption. One source of the relative decline of the United States as an economic power is that a large part of the surplus was allocated to the military establishment, another source was that a large part of the surplus was allocated to support a large, expensive and often inefficient corporate hierarchy, and a third source is that the rentier was resussitated and an increasing part of the surplus was allocated to the support of high level consumption. The difference between the advanced economies and the semi-industrialized countries is not that inefficiencies are absent in the rich but that being rich they can afford their inefficiencies.

The 1980's began with Capitalism in crisis: the double digit inflation was associated with spans of double digit unemployment. Economists in the United States who service politicians developed a misery index, which added the inflation rate and the unemployment rate, to damn the Carter regime and the first two years of Reagan's presidency. The failure of the 1970 style econometric models to forecast the double digit inflation and double digit unemployment and to provide a basis for useful policies to prevent such developments was a key element in the abandonment of the Keynesian orthodoxy that had served policy makers well over the prior forty years.

The monetarist vision that supplanted the orthodox Keynesian vision as the 70's gave way to the 80's did not survive the 1980's as an operative guide to policy. Today there is no common vision that guides macro-economic policy in the United States. Macroeconomic policy is essentially ad hoc and opportunistic.

Furthermore policies based upon deregulation, i. e. supply side policies are increasingly in bad repute. The initial burst of competetion in airlines has been replaced by increasing monopolies and exercises of monopoly power. The deregulation of financial institutions gave rise to what seems like a burst of corruption in the thrifts and the development of heavily indebted liability structures in industry and trade that are acting as barriers to investment.

In the United States the 1980's saw Reagan triumphant. A policy mix that tolerated unemployment at levels not seen since world war 2, that used government power and an overvalued dollar that generated massive imports to weaken unions and unprecedented fiscal deficits brought about by massive increases in military spending even as income taxes were cut led to the recession of 1981-2 being followed by a long business cycle expansion. This business cycle expansion is still continuing. A luxury and mass consumption boom in the United States resulted in this expansion spilling over to Japan, Western Europe, the other rich countries and a variety of export oriented newly developing economies. This long and generalized business cycle expansion, coming at a time when the Soviet style economies were in crisis, has been taken to signify that capitalism has triumphed.

The massive United States import surplus of manufactured goods, which was a useful weapon for bashing labor, led to a still continuing erosion of United States manufacturing and a massive United States trade deficit. The result is that the United States is now the world's largest international debtor nation. Foreign ownership of manufacturing and trade enterprises in the United States is now common.

The victory of Capitalism over Communism which was celebrated in Paris last July is due to the success of Capitalist economies in avoiding a serious depression over the forty plus years since world war 2. Of course this victory means that the failures of capitalism in Latin America are ignored. It also means that the victory of capitalism is secure only as capitalist economies succeed in avoiding another great depression.

What the celebrants of the victory of capitalism overlook is that in 1933 capitalism was a failure well nigh everywhere.

The post world war 2 capitalism that is apparently so successful is far different from the pre world war 2 capitalism that failed well nigh everywhere. The capitalism that failed was a small government fundamentally non- interventionist economy. It was much closer to the laisse faire model beloved of academics and the right than the post war economy. The post war economy is characterized by a large government, especially when compared with the pre war economy. In 1929 the United States Federal Government was about 3% of GNP. In recent years the United States Federal Government was about 25% of GNP. This large government spends on transfer payments such as social security, the military, and a variety of resource creating and service functions.

Furthermore the central banks are much more active in sustaining financial institutions and in assuring that the flow of financing from banks to industry and trade is not disrupted. This is so because the Central Banks are not tied to constraints derived from the gold standard. Furthermore whether they admit it or not Central Banks accept some varient of the Fisherian debt deflation model of business cycles as a possible outcome of financial trauma.

The post war world 2 capitalism can for want of a better name be called Keynesian Capitalism. In these structures government uses fiscal policy to sustain aggregate demand and the central bank stands ready to support a wide variety of financial institutions to assure that a debt deflation does not occur. A chronical of

Federal Reserve "lender of last resort interventions" in the United States is well known. This chronical shows that such interventions have increased in frequency as the years have elapsed since 1968 and they were especially frequent during the 1980's. The ability to overcome financial disturbances during the 1980's was due to the large government that sustained profits and the active refinancing by the Federl reserve.

The government extracts a surplus from the economy by its taxing and its debts. It uses this surplus to support consumption in the form of social security and other transfer payment schemes such as interest on the hige federal debt and military spending. In the United States the government now does relatively little in the way of rresource creation either by investing in plant and equipment or in improving the productive capabilities of the labor force.

The surplus extracted from an economy can be used to support "rentiers" consumption and to finance resource creation (investment) by private industry and the government. It matters little whether the surplus is extracted by the private markets or by taxation. The financial system of a capitalist economy is a device for extracting and allocating the private part of the surplus. The government through taxation and borrowing extracts a surplus and its budget spends or allocates the surplus.

This taxonomy leads to the Kalecki type equations which hold that for a closed economy:

1. Pi = I + Gov. Def.
2. Gov. Def = Gov Sp. - Gov. Tx.
3. I + Gov. Sp. = Pi + Gov. Tx..

In other places I have paid much attention to the need to sustain profit flows for a capitalist economy so that business debts are validated, for incentives for further investment to be apparent and for financial resources to be available from the financial institutions.

I now want to turn to the qualitative dimensions of I + Gov. Sp. and Gov. Tx.. Private I, although errors often occur, is disciplined by the need for expected cash flows from operating the investment in the environment that is expected to rule will be sufficient to fulfill the commitments on liabilities with a goodly margin to spare. Although sceptical bankers recognize that the pro-formas which accompany loan applications paint rosy pictures, nevertheless all private investment is constrained by the need for scenarios, no matter how fanciful, in which the investment "pays off". This discipline means that debts can grow in the aggregate if the investment put in place means that the productive capacity of the economy also grows.

This discipline is often lacking for public investment. Both public and private investment may require subsidization: many corporate investments pay off through the benefits other investments of the corporation derive. Conscious cross subsidation is not ruled out for public investment, but it must be a conscious decision.

Government creation of resources is often necessary when for any one of a myriad of reasons private markets cannot do the job. This is especially so if capital markets are underdeveloped or if consumption is very high relative to incomes so that financial markets cannot force a surplus out of the economy without generating inflation. When that happens the taxation system needs to step in and extract a surplus. This is a logic that supports consumption based and import taxes in poorer countries. It must be recognized that many of the dimensions of the welfare state provide luxuries to the rich. The state must discipline its spending so that they are resource creating.

The ability to tax is a limiting factor in what the public sector can undertake. If there is a large domestic currency indebtedness then the tax structure must pay the interest on the debt. Keynesian fiscal policy accepts deficits in extraordinary conditions, but the basic governmnet spending program, including the interest on the domestic owned national debt, must be covered by the tax receipts from the schedule in place when "normal" economic conditions rule.

If the capitalist road to development is taken then one cannot escape the need for an effective and efficient financial structure that has a deep and wide investment banking function. In the poorer countries this most likely best takes the form of decentralized banks that are not limited to the "colonial" commercial banking function but which can finance the acquisition of productive resources.

We can distinguish four stages in the United States financial development. These are commercial capitalism, industrial capitalism, managerial capitalism and money manager capitalism. Under commercial capitalism the banking structure is but little involves in the financing of capital assets. Commercial capitalism is the model of colonial finance where the banking system is mainly concerned with the financing of goods in the process of trade and production and not with the financing of investment. In such structures the financing of utilities and railroads, to use examples from history, are mainly carried out in offshore financial markets.

In industrial capitalism the main players are the investment bankers who seek out and finance new and developing industry. It is my view that the investment banking function is often not well developed. managerial capitalism is a structure in which the management of corporations are not dependent on financial houses for their financing of investment. The ongoing attempt by some pension funds to have a voice in the selection of the next generation of leaders of General Motors may mark the demise of the last stronholds of such managerial autonomy. It can be argued that this model achieved its success when government through its deficits became the main spring of aggregate profits.

The new development is money manager capitalism, which may have reached its present development because of the success of the main capitalist countries - particularily - the United States in avoiding a serios recessio in the post war era.

From my observation of both the United States and Italy I firmly believe that a multi layered banking system that includes local, regional and national banks is a plus for economic development. Thus the centralization of the banking system into a few large banks is to be avoided and where it exists measures should be taken to open the system to competetion..

Furthermore the development of a decentralized investment banking structure that performs the venture and post venture stage financing is highly desirable. These decentralized banks should not only finance investments but they should also develop mutual funds and other mass scale investment instruments. Because of the limitations on the size of any particular credit that is set by the capital of a bank, a decentralized banking structure, which implies a multitude of smaller banks, also implies that many profit seeking organizations exist which derive their profits from financing small business.

The semi - industrialized countries with heavy inherited international indebtedness are effectively barred from financing a resumption of growth by international borrowing. The shadow of Noriega implies that unilateral repudiation is not an option. A funding of the international indebtedness into a concessionary rate long term debt is necessary and I hope negotiable.

The need is to develop a development strategy that uses domestic financing and domestic available inputs to create resources. The model I suggest is the labor intensive employment and work projects of the New Deal in the United States: a program that uses government to develop the infrastructure for decentralized development.

The resumption of growth in the semi - industrialized states cannot be dependent upon an easing of the international indebtedness burden, although an easing through a funding is desirable. Any development program in the foreseeable future must recognize that internationally sovereign debt of the presently indebted countries is in bad repute. The hope for such countries to reenter the international financial markets depends upon the development of private debt forms that are closely tied to the performance of specific assets and where the capture of the underlying assets in case of non -

performance is guaranteed by enforceable law. The development of securitization means that each country has to ask what will it take in the way of laws and performance for liabilitie based upon our assets to be acceptable in the markets for securitized instruments.

The above is true of both the eastern block countries and the Latin American countries. In both of these blocks of semi - industrialized countries there is a need to develop internal sources of financing. It would be tragic, and a guarantee of future difficulties and breakdowns, if enterprise financing came mostly from abroad. This implies in both cases that the initial impetus for recovery and expansion should come from smaller enterprises and that development should be biased away from the great metropolitan centers.

The Latin states do have an advantage over the Eastern European states inasmuch as for their enterprizes histories of profits are available and therefor there is some economic basis for valuing assets. In Eastern Europe no such history of profits is available: no rational valuation proceedures are available, only more or less fanciful scenarios.

Recovery and expansion of the semi industrialized states will not be easy. Perhaps the breakdown of the Soviet style states in Eastern Europe offers an opportunity. For the next several years Latin America may well be off the agenda. This may give Latin America a chance to develop on the basis of your not inconsiderable domestic resources. After all being semi - industrialized means that much of Latin America is part way there.