March 1933 / March 1993

March of 1933 is a watershed in the American experience. When the month began the economy was chaotic: the financial system was in a terminal collapse, industry was at a standstill, agriculture was in revolt, and for many gainful employment was a dim memory. During the next one hundred days a vast array of legislation marked the beginning of a New Model Capitalism. As President Clinton has emphasized the first two Roosevelt administrations were an era of experimentation in which the institutions of capitalism were changed and then changed again. Nevertheless the basic institutional structure that was put in place during the era of experimentation served the country well.

In October 1929 a great contraction of the economy began. Thirty months later in March of 1933 the collapse was virtually complete: an enormous impoverishment had taken place. Encampments for the homeless, called Hoovervilles, dotted the landscape. In the midst of an enormous capacity to produce plenty, poverty reigned.

Even though the economy was nowhere near the thorough failure it had been in 1933, the economy resonated with that
of Hoover's time in 1991-92, for a collapse of the financial system seemed imminent. In the past six months the fear of a financial collapse has subsided and a mild recovery has set in. Both the abatement of fear and the mild recovery are mainly the result of lower interest rates. As memories fade of close we were to a serious depression one year ago consideration of how to revamp our financial system have been put on the back burner. The Clinton reform program is not overtly directed at reforming the financial system. Rather the Clinton program as unleashed to date seems to be taking aim at some legacies of the economy put in place after World War 2 that needs adjustment. As it is far, far better to rethink the structure of our financial system when there is a respite from crises than when a crisis dominates action, we should actively consider what is needed to set the economy on a sustainable growth path now.

Roosevelt's clarion call "The only thing we have to fear is fear itself" on inauguration day sixty years ago marks an historic turning point. It expressed the will to create a new capitalism which would sustain an approximation to full employment and create barriers to prevent a repeat of the financial debacle. Laissez faire - the doctrine of passive government because "the market always knows best" - was set aside. The New Deal meant that in the future economic well being was to result from the joint efforts of
an active government, popular organizations, and private enterprise.

Recovery and reform were the twin economic policy goals of the New Deal. The reforms created a capitalism in which government regulated finance, policed markets and was a greater share of the economy than in 1929. The New Deal inaugurated an era of big government capitalism.

Substantial improvements in the economy came quickly. By 1937 recovery was accomplished. A sharp but short recession took place following 1937.

For more than 30 years after 1939, through war and peace, the new capitalism was associated with an unprecedented prosperity in which gains were distributed widely. The first 20 years after the second world war stands as a practical best for American economic performance. The New Deal model of capitalism was an apparent great success.

New Deal capitalism was far different from the failed laissez faire capitalism of the era prior to 1929. The New Deal had changed the financial structure, fostered resource creation, supported competitive industries, created safety nets for personal income and placed barriers in the way of downward price flexibility. Direct employment by The Civilian Conservation Corps, the National Youth Administration and the Works Progress Administration put otherwise idle resources to work. The safety net to
personal income created by the New Deal made income from work available for all.

Financial reforms eliminated the gold standard, insured deposits, compartmentalized banking and finance, provided for closer regulation and inaugurated transparency in both corporate finance and financial markets.

Resource creation took many forms: public works, rural electrification, TVA, other river projects, reforestation, land reclamation and public housing. Active anti trust policies fostered competition. Unemployment insurance, Social Security and government fiscal policies provided guarantees against sharp declines in personal incomes and business profits. Agriculture price supports, minimum wages and government protected trade unions served as barriers against a free fall in the price level.

Stresses and strains in the New Deal structure became apparent in the 1970's. Strong and responsible trade unions, highly localized and narrowly focused savings and loan associations and effective anti-trust, all of which had contributed to the success of the new capitalism, diminished in importance.

The compartmentalized financial system, that was put in place in the 1930's, fostered enterprise and investment. New communication and computation technologies, institutional evolution, such as the rise of pension funds, legislated changes, such as broadening the asset base of
savings and loans, and mistaken policy, such as monetarism, transformed the financial system. In the 1980's enterprise became a bubble on a sea of speculation: Casino Capitalism took over. Many balance sheets of firms, banks, savings and loan associations degenerated so that they were unable to fulfill their commitments. It has taken a massive infusion of government money into the financial system and enormous peacetime government deficits to prevent the 1990's from replicating the disasters of 1929-33. The 1990's tested the New Deal defences against the replication of the 1929-33 debacle and the defenses held.

Capitalism is an economic system that is not frozen in stone: it can take many forms. As one form breaks down another can be developed, perhaps in the womb of the old. The power of the institutional structure that was put in place in the 1930's to lead to a successful capitalism seems to have deteriorated as the 1970's ran its course. Certainly over the past twenty years American capitalism has not been as successful as it had been over the prior twenty years.

In the Reagan and Bush years policy took a laissez-faire turn, albeit accompanied by massive defense spending and huge government deficits. As in the 1930's, laissez-faire has given us a capitalism whose performance falls short of the success of the earlier decades.
To once again make capitalism a success a New New Deal is needed. This 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 nevertheless serve as prototypes.

2). Greater Federal government financing of infrastructure investments and the creation of National Research Universities and Institutes.

3). A banking and financial system which emphasizes banks which are community oriented and whose mission is clearly put as financing the capital development of the country. Banks should be constrained from 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.

6). Vested defined contribution pension systems to supplement social security. (Job related health care financing and pension systems are obsolete in today's competitive environment.)

7). A tax system that equitably finances government and is approximately balanced at full employment.
8). A 10% to 12.5% duty on all imports. This duty to replace all quotas and other special protections of domestic production, regardless of whether the protection measures are administered by the United States or by the exporting country.

The message from our history is loud and clear: an activist Federal government, which is committed to the principle of full employment, is necessary for capitalism to be successful. In 1933 the country recognized that the disasters of 1929-33 were not due to a shortage of resources but to the ideological blinders which wedded policy to laissez faire. Since 1980 economic policy has ignored this precept. Just as in 1933 we need to cast off the blinders of "the market always knows best" to assure the success of our economy. The Clinton economic plan is a good first step in reaffirming the need for active government to overcome the pervasive tendency for free markets to fail to deliver a successful Capitalism.

-----------------------------------

Hyman P. Minsky,
The Jerome Levy Economics Institute,
Bard College,
Annandale on Hudson,
NY 12504

Office Phone # 914-758-7448
Office fax # 914-758-1149