

By Hyman P. Minsky

On January 27, President Ronald Reagan delivered the annual State of the Union message to a joint meeting of Congress. The reception he received demonstrated that he has lost control over the policy agenda: this was most graphically shown when the Democrats greeted his *pro forma* call for a balanced budget with derisive cheers and applause. Effective power visibly shifted to the Democrats as Reagan, the now naked Emperor, passively accepted being mocked. (If the United States were a parliamentary democracy there would now be a new prime minister.)

Two domestic policy initiatives, the extension of medical care for the aged to cover catastrophic illnesses and improving education so as to become more competitive in the world economy, were included in the President's message. The President was vague on the details, nothing specific was proposed. The implementation of one or both of the President's wishes would involve greater government intervention and funding than is his professed philosophy of government.

Medical care for the aged and improved education and educational opportunity are natural Democratic issues. Reagan's message inadvertently legitimized not only these Democratic initiatives but others that may be advanced to meet what will be called overriding national needs. This gaffe illustrates that the Reaganites have lost much of what had been a sure political touch.

Capitalism misunderstood

But more than Reagan has lost power. The campaign for a smaller and non-interventionist government, which was the centerpiece of Reagan's conservatism, has collapsed. This small government conservatism failed because it misunderstood both the American people and the nature of modern capitalism.

Economic conservatism as advocated by Reagan, denying the validity of government intervention in the economy, is an unnatural posture for Americans. The natural American conservatism, which has its roots in the thought of Alexander Hamilton and which President

Theodore Roosevelt represented, advocates the use of government to advance business interests.

The Reagan aberration developed and gained popular support because the New Deal programs of the 1930s, when combined with massive military spending and foreign adventures, developed undesirable side effects such as inflation and a subculture of welfare dependency. The inheritors of the New Deal tradition—Kennedy, Johnson, Humphrey, McGovern and Carter—were not sufficiently agile politically to modify and adapt the New Deal inheritance to changed circumstances. Reagan has

left anywhere else in the world in that they are not anti-capitalist. The American socialist movement peaked in 1912 and then floundered until its demise during the second World War. Since World War II, the United States has not had a strong and reasoned political force with deep roots in the country that is anti-capitalist or at least skeptical of the claims made for capitalism.

The Communist Party's successes in the 1930s were shallow. They depended upon their support of Roosevelt, their largely covert involvement in the C.I.O., and their anti-fascist posture. Fundamentally, the Communist Party of the

THE ECONOMY

from the not-so ivory tower

The end of the Reagan era

cleared away some of the programs that hurt the Democrats through the 1970s without decreasing the need for positive income maintenance and employment policies. As a result, the modernization and reconstruction of what can loosely be called the welfare state is now on the political agenda. This modernization and reconstruction is what Americans expect of the Democrats.

Left not anti-capitalist

The Democrats often are called the American left, but they are unlike the

United States was superficial, devious, and largely irrelevant. Its major relevance may have been that its artificial creation was an important factor in the failure of the Socialist Party to revive after its losses during World War I, losses which resulted from its honorable opposition to American participation in that war.

This political history means that American economic policy is made without the benefit of a critique of capitalism as such, without an awareness that capitalism is inherently flawed. These flaws are not only that financial crises and economic depressions are normal events but also that intervention is necessary to contain poverty, create resources, and sustain competition. The profitability of enterprise, which is central to successful capitalism, tends to break down unless supported by government resources creating activity that leads to the emergence of opportunities for private profit.

Capitalism dependent on government

From its earliest days, American capitalism has depended upon government to create material and human resources which effectively sustain opportunities for private investment. Government always has been expected to facilitate economic development; such positive intervention may be the true American

contribution to economic policy.

A revived and effective Democratic Party will need to develop programs for prosperity that are based upon a partnership between government and business and to combine these with a new version of the public employment programs that were so successful in the 1930s. The shift will have to create income through employment rather than through transfer payments (welfare).

One facet of the American ideology that the Democrats need to exploit is the commitment to equality of opportunity. Equality of opportunity has always been a major policy objective in the American ideology and, in the dominant view, government has a major responsibility to advance such equality. It is recognized that disparities in family income and wealth distort equality of opportunity. The inference that is drawn is that government must play a positive role to keep opportunity open, not that government must take substantial steps to reduce disparities in income and wealth. The American commitment to free public education and the great state university systems, which are strongest in the Midwest, are visible symbols of this commitment to opportunity.

That Reagan can be safely mocked and that the Reagan brand of economic conservatism is now without programs of substance does not mean that the Democrats have a clear road to an effective Presidency in two years. The Democrats need to develop policies that not only address the issues of equality and fairness, they also have to come up with policies that address the unbalanced budget, the deficit on the balance of trade, and the failure to approximate full employment.

Democrats haunted by inflation

Policies for the above must be developed even as it needs to be emphasized that a resumption of the inflation of the 1970s will be avoided. Inflation is an embarrassing problem for Democrats, for Reagan succeeded in lowering inflation by accepting high unemployment rates and by bashing unions. In the United States and in Europe, a new philosophy of unionism has to be developed which recognizes that excessive wage pressures lead to inflation. The emphasis in unionism needs to shift to job security and the real income workers receive outside their private pay packet.

Today, fears prevail of both a financial breakdown and a recession or depression in the near future: even *The Wall Street Journal* features such concerns on its front page. If this occurs, then the election of 1988 will go to the Democrats. Complacent, they will neglect to develop policies for the issues that the next president will face.

It seems clear, a tax program that faces up to the deficit will need to use excise and value added taxes to a greater extent than Democrats have favored in the past. The problem of trade imbalances requires a radical shift of monetary and fiscal regimes so that the principal economic powers cannot use beggar-my-neighbor policies to enrich themselves. In a world without the possibility of beggar-my-neighbor policies, the United States and the other rich countries will need to rely on direct government employment to a greater extent than in the past in order to approximate full employment. The Democratic programs to sustain aggregate demand in the years from Kennedy through Carter relied much too heavily on stimuli to business and tax abatements; the post-Reagan programs will need a greater emphasis on direct employment.

Reagan's early successes in legislation and with the public were a reflection of a generalized running down of the programs that had brought success to capitalist economies after World War II. In particular, private interests seemed to be exploiting these programs. The major problem for the Democrats (and perhaps of the left throughout the capitalist world) is to develop new programs of government intervention into the economy without echoing solutions that were tried in the past and eventually led to adverse side effects. The need is to recognize that not only is intervention necessary to offset the flaws of capitalism but also that any particular program of intervention will lose its effectiveness in time. Capitalism can be made to work tolerably well by apt interventions. But as capitalism evolves, any appropriate policy at one time becomes inept later. Continuing adaptations are necessary, if society is to sustain a human face.

Hyman P. Minsky is a professor of economics at Washington University, St. Louis, and a regular SJR columnist.

The campaign for smaller government has collapsed

Democrats need to address unbalanced budget

As capitalism evolves, any appropriate policy becomes inept later