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Recession - But Not Depression - In Offing, Part 2

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THE ECONOMY

from the not-so ivory tower

Recession—but not depression—in offing

By Hyman P. Minsky

The Mont Pelerin Society is an organization of right-wing, free-market ideologues who happen to be economists. Luminaries such as Friedrich Hayek and Milton Friedman were among its founders in 1947. According to Lindley H. Clark Jr., writing in *The Wall Street Journal* of Sept. 24, a meeting of the Society, which included several who had been active in the Reagan administration, recently took place in Indianapolis. At this meeting, an unidentified Mont Pelerin member commented on why so many presidential possibilities are on the sidelines by remarking "They may feel that we have to have another Hoover before we get a Roosevelt."

This feeling that another Hoover is imminent is, of course, the fear that another Great Depression is in the offing, and that real economic reform will come only after such a disaster. It is surprising that Franklin D. Roosevelt was spoken of favorably, for the doctrine of the Mont Perlin Society as enunciated by Hayek is that Roosevelt started us on "The Road to Serfdom." Never has a prediction of an emminent scholar been more "off base" than Hayek's in that unjustly famed volume.

The fear that the next president will be another Hoover (which had been voiced by Chrysler's Lee Iacocca in January when he turned aside suggestions that he might be a candidate) reflects an awareness that the present "prosperity" is precarious and that the financial market booms and manipulations, so prominent in the press, may be setting the stage for a financial crisis and collapse.

However, neither Iacocca nor the unidentified conservative economist cited by the *Journal* seem to be aware that even though the next recession might be severe, there is no rational reason in our post-Keynes world why it should be as severe as the collapse that ruined Hoover's presidency and made his name a synonym for disaster.

We might very well have a recession in the near future that will be more severe than any we have had since World War II but that the result need not be anywhere near as severe as what happened during the Hoover administration. In Hoover's years, we had a contraction that lasted 42 months. Prices declined 30 percent, as did output.

The unemployment rate stood at 25 percent and the Dow Jones fell by 85 percent. In today's market, an equivalent fall in stock prices would lead to a 400 Dow Jones.

Furthermore, no one expects the government to be so enamored of free market principles that it would stand aside while the banking and financial system falls apart. Although some 450 thrift institutions are really bankrupt, the recent action of Congress that pumped over $10 billion of funding into the savings and loan deposit insurance organization is proof positive that the availability of deposits to depositors will not be interrupted, no matter how bad the assets of the thrift institutions may become.

The next president who has to confront the likelihood of a recession will have the doctrines of Keynes and Keynesian economists (if he has the sense to turn to them) as a guide to avoid another Great Depression. The conservative economist cited in the *Journal* might have to reject some earlier views if he turns to Keynes for guidance, but he well knows that a combination of Keynesian-demand management and effective central bank interventions can assure that any developments in the economy that point towards the emergence of a Great Depression can be aborted.

The president confronting the next recession will have to orchestrate demand management and financial market interventions to contain and reverse the recession before the downturn gains too much momentum. Unfortunately, he will have to operate in an environment bequeathed to him by President Ronald Reagan. From the point of view of the longer term health of the economy, Reagan has been a disaster.

The "prosperity" we now enjoy is mainly based upon a radical un-Keynesian Keynesian budget policy running at huge deficits throughout an economic expansion. This has been combined with monetary ease, that has been augmented by new monies created as a byproduct of deregulation, which has financed a consumption boom and union bashing, which uses government actions, unemployment and the encouragement of imports, to contain wage increases. Recently former Federal Reserve Chairman Paul Volcker denied that Federal Reserve monetary policy brought inflation under control. He argued that major credit should be given to Reagan's breaking of the air-controllers union.

In addition, the Reagan administration has stood aside as the United States became a major debtor nation. Just as Latin America is a financial colony of the United States so the United States is now a financial colony of Europe and Japan. The next president will need the courage to confront Japan and Europe over their beggar-my-neighbor trade policies.

A sophisticated and progressive Keynesian approach to the problems the United States must confront to emerge from the next recession with a healthier economy includes:

- a budget reform that requires that deficits be either contracyclical or due to an emergency.
- a flexible jobs policy that assures that income from work is always available using the WPA, CCC, and NYA of the Roosevelt years as models.
- a universal children's allowance, which combined with the jobs program will enable us to dispense with anything but emergency welfare.
- a wage-and-income policy aimed at preventing the dissipation of the employment and output effects of demand management by inflation. This would include a new compact with labor, making job security the main objective; measures to contain the ripping off of government programs such as medical care, defence, and education by the providers; and anti-trust policies.

Thus potential candidates who are on the sidelines should not let the fear of being another Hoover keep them from entering the race, provided that if elected they will have the good sense to draw their economic advice from sophisticated Keynesians and not from members of the Mont Pelerin Society. ■