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Is Reagan Coolidge or Hoover

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from the not-so ivory tower

By Hyman P. Minsky

January is named for the two-faced Roman god, Janus: one face looks forward and the second looks back. In deference to its god, January is when we review the recent past and think about the near future. It is the season for economic forecasts.

Economies are special types of organizations because the important decisions, those that deal with investment and financing, are always forward looking and, therefore, based upon expectations of the future. But these decisions are constrained by the legacies and what is believed about the past. Economic decision makers not only heve to look forwards and backwards, as Janus would have them do, but they need to operate in the present.

For those deeply involved in the stock market, 1986 was a good year and if you were a professional employee or a partner in a financial house, it was an exceptional year: the year end bonuses on Wall Street were terrific. The merger, takeover, and the sophisticating-of-finance "industries" may very well have enjoyed their best year since 1929. Employment and income earned in farming, manufacturing, and extracting became less important even as financial services increased in importance. The new products of American business in 1986 were not new generations of VCRs or high quality automobiles but equity mortgages, diamond credit cards, and the securitization of assets.

Because of the huge deficits in foreign trade, the Europeans and the Japanese accumulated massive amounts of dollars. Salomon Brothers Inc. estimates a 1986 gross capital inflow of $191 billions and a gross capital outflow of $50 billions; the net selling of America amounted to $140 billions. In essence, the United States government and the well to do among us were able to go on a huge spending binge by selling assets.

Borrowing or selling assets can be productive when it is used to finance business investment and investment in humans: in 1986 investment declined. The economics of Reagan is the economics of a wastrel state.

For those seeking work, 1986 was a bad year—unemployment did not get below 7 percent for the capital development of the country. It also was a bad year for the government budget, the Treasury's debt grew by $194 billions, and the international deficit reached $150.4 billions. At this rate, the international deficit will impoverish the country.

But 1987 may very well be worse and possibly much worse than 1986.

Lee Iacocca is reported to have said, "The next president, he's going to feel like Herbert Hoover after the jazz age of Coolidge and he's going to bear the rap." Maybe not. If the slack of 1986 turns into a recession in 1987, Ronald Reagan will be the Herbert Hoover of the second part of the 20th century.

Using the other face of Janus to look forward, what is in store for 1987? Forecasting is now a business, although many of the forecasting firms are marking losses.

We can distinguish three types of forecasters, the Pollyannas who see only positive outcomes, the Cassandras, who see only doom and gloom, and the realists, who recognize the fragility of prosperity in a highly indebted situation, but who also understand the built in floors which keep the economy from falling too far.

The Pollyannas are usually dominant

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in government, although they find customers in the business community. The Cassandras are most often found among financial advisers, although economists who work in investment banking have been known to warn of the dangers of overindebtedness. The realists recognize that in the after-Keynes world in which we live, a repetition of the 42-month decline of the Hoover administration could occur only if goverment was dominated by strange free-market ideologues.

The current expansion began in November of 1982, when the deepest recession of the 40 years since 1946 took place: this current expansion is now in its 50th month. Thus, this expansion is longer than the average post-war expansion, so a recession may be due. However, if a recession occurs in the near future, it will begin from a higher level of unemployment than earlier recessions.

In the recession of 1970, which was associated with the Penn-Central Railway's failure, unemployment rose from just under four percent to six percent, and in the recovery that followed unemployment never got much below five percent. During the recession of 1974, which was associated with the failure of the Franklin National Bank and the difficulties of the Real Estate Investment Trusts, unemployment rose from five percent to nine percent, and in the recovery that followed it never got significantly below six percent.

The brief recession of 1980 was quickly followed by a long and deep recession in 1981–82. Over this period, unemployment rose from six percent to 11 percent: this recession was associated with the failure of the Penn-Square Bank of Oklahoma City and the Latin American (in particular Mexican) debt crisis. The false Reagan prosperity has reduced unemployment to seven percent, and has been characterized by large-scale financial losses (Continental Illinois Bank "failed" in October 1984.) as well as the financial adventuring of the merger and take-over movements.

The overbuilding of commercial real estate in many markets, the enormous indebtedness of households, and an expected decline in business investment all point to a poorer 1987 than 1986.

Salomon Brothers Inc., which has a reputation for being hardnosed, forecasts that real GNP will increase by only 2.1 percent in 1987—the increase in the unsatisfactory 1986 was 2.7 percent. The economy will be close to or below its stall speed. Furthermore, the financial structure, which encompasses the now more highly leveraged business sector, a household secter whose installment debt is approaching 20 percent of household disposable income, and banks as weak as the Texas banks, is now obviously more fragile than earlier in the post-war period.

If the Salomon Brothers forecast is only a mite on the optimistic side so that a downturn occurs, then a recession in which the unemployment rate quite quickly runs up from the present seven percent to well in excess of 11 percent is likely to occur. This does not mean that a 1929–33 contraction will take place; the Federal government has become much too large a part of the economy for that to happen. However, a recession that begins early in 1987 and that lasts for about 18 months and which is at least as unemployment creating as the 1981–82 recession is likely to occur.

The Iran affair is leaving the Reagan foreign policy of militant right wing anti-communism in disarray. A recession in 1987–88 is likely to reveal that the much touted Reagonomics was empty of substance. Iacocca may have been very wrong: Reagan will most likely not turn over a prosperous economy to a successor. He is no Coolidge: he may not get out in time. ■

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