1-1-1987

New Deal Brought Economic Success

Hyman P. Minsky Ph.D.

THE ECONOMY

from the not-so ivory tower

New Deal brought economic success

By Hyman P. Minsky

The Reagan Republicans suffered three defeats in November: They lost the Senate, hanky panky on Wall Street revealed a flaw in free markets, and the uncontrolled National Security Council showed that right wing anti-Communism is an unrealiable shield for freedom. The resulting loss of Reagan's credibility has increased the value of the Democratic nomination in 1988. The count down to the nomination in 1988 has begun.

Theodore Roosevelt characterized the presidency as a "bully pulpit." Reagan was the most proficient user of the presidency to control the public agenda of what was discussed since Franklin Roosevelt. Reagan will not be able to control the agenda during the next two years. Credibility, like virginity, can only be lost once.

Will Rogers remarked that "I belong to no organized party, I am a Democrat." For the Democrats to regain the presidency, they will have to give the lie to Will Rogers by developing a coherent perspective on critical issues. Their agenda cannot be seen to be a rehash of the programs of the pre-Reagan era.

The real test of how well the Democrats use their control of the agenda will come on economic issues. Over the past decade, the Democrats have been on the defensive on economic policy. Such defensiveness is unwarranted.

New Deal Successes

Democrats need to emphasize that the economy's success over the past 50 years was mainly due to the reforms which began with the New Deal. The decades of prosperity after World War II were not the result of unfettered "free market" capitalism: the virtually unconstrained free markets of the 1920s led to the Great Depression of the 1930s. The most remarkable economic fact about the forty years since World War II is the absence of another major depression. The history of our economy over the 20th century shows that big government interventionist capitalism—which the Democrats put in place—is less prone to depressions than small unregulated capitalism—which is the Republican aim.

However, *a depression free economy is a transitory affair, it involves an internal contradiction.* In the absence of depressions liability experimentations by business and banks, which takes the form of increased indebtedness, is profitable. But this leads to payment commitments that cannot be fulfilled without inflation. If the Federal Reserve takes measures to contain inflation then the financial structure becomes fragile, i.e., it becomes crisis prone. When a crisis seems imminent the authorities feel forced to bail out weak banks and even key businesses. After a pause this tends to rekindle inflation.

Experience since the late 1960s shows that government activities and interventions that are effective in an economic environment dominated by the fear of depressions are likely to become inappropriate as the economy succeeds in avoiding depressions. It is said that we can never swim in the same river twice. Likewise, interventions never take place in the same economy twice. As a result of the evolution of the economy some interventions and regulations which were appropriate when they were introduced in the past have had seriously undesirable effects in recent years.

A modified structure of government interventions in the economy is needed. The development of such a structure will not be easy. If the Democrats take the easy route and use their control of the agenda to advance a laundry list of economic programs that look like the proposals of the 1960s, the Republicans will be able to get off the hook.

In 1958, the Democrats were in a similar position. A politically successful Republican president, Eisenhower, was finishing his second term and the Democrats were in control of both houses of Congress.

A great and creative economist, Paul Douglas, was a Democratic Senator from Illinois in 1958. Using his seniority on the Joint Economic Committee, Paul Douglas chaired a special congressional investigation into *Employment, Growth, and Price Levels,* which set out a critique of the economy as it was and developed a program to improve its performance. This Douglas Committee provided the intellectual basis (as well as some of the personnel) for the economic policies of the Kennedy administration.

Major study needed

One way the Democrats should use their control of Congress is to set up a major study of the American economy. The aim should be to advance our understanding of how the economy actually works, what is wrong with the outcomes, and what can be done about its defects.

Two facts should guide the congressional study:

1) Our country is now a much weaker economy, relative to Japan and Western Europe, than it was six years ago. This is largely but not wholly due to the policies of the Reagan years. The dimensions of our weaknesses have to be determined and programs to offset them have to be developed.

2) The Reagan prosperity is a truly false prosperity. It is not based upon the strength of our productive machine, it is based upon our ability to support consumption (including the military budget) in excess of production by borrowing and selling assets. As a country we are living high off the hog by eating into our national capital. Reaganomics, touted in 1981 as a way of improving productivity and economic growth, has degenerated into a discount sale of American assets.

Three glaring and obvious dimensions to our current economic weakness are: The huge government budget deficit, the massive international trade deficit, and the 7 percent unemployment rate during "prosperity." The congressional investigation will need to end up with recommendations to solve these weaknesses.

The budget deficit cannot be attacked without first determining the appropriate scale of government spending on defense and civilian functions. Whereas big government is necessary for depression prevention, there is no reason to believe that it need be as big as our defense and debt bloated government now is. To support the required government, a modern tax system is needed which raises sufficient revenues to balance the budget at appropriate stages of the business cycle and which is not as dependent on income taxes as our present system. Preparing the ground for tax reform that goes beyond the income tax should be high on the agenda of the study.

The international trade deficit is now attacked by various ad hoc quotas on imports. An exporter-administered quota system, such as now rules the export of Japanese automobiles to the United States, is far worse than a reasonable, across-the-board tariff. A tariff for revenue that is levied at the same rate on all imports makes sense and has a beneficial effect on the government budget deficit. However, such tariffs must be combined with resource development programs that make our workers and business management well trained and productivity oriented.

Labor costs have been unfairly blamed as the cause of our international trade problems. As is evident from the continuing tragi-comedy of General Motors, something is seriously amiss in our industrial structure. Management deficiencies and the monopolistic nature of much of our industry are major causes of the international trade deficit, our chronic unemployment, and the slow growth of productivity. The development of programs that promote industrial competition needs to be on the agenda.

The crime of 7 percent unemployment has at least two dimensions. One is that the unemployed are dependent upon transfer payments rather than being self-supporting and productive. The second is that the young unemployed, are deprived of the opportunity to learn by doing. Chronic unemployment is a failure to develop human resources.

CCC essential

Programs that will assure a closer approximation to full employment than we have been able to achieve over the past decade and a half, without just pumping up aggregate demand so that inflation is rekindled, need to be developed.

A 1990s version of the New Deal's Civilian Conservation Corps which will target spending to youth unemployment will be an essential ingredient to the creation of a full-employment program.

Democrats have to come to grips with the fact that Reagan was able to break inflation by weakening unions. A new policy towards unions is needed. Government support of unions needs to be structured so that inflation does not result from strengthened unions. Relations between government and unions is one area of policy where it is much easier to state desirable ends than to formulate policies to achieve those ends. Careful congressional hearings and study of these issues is necessary.

Although Reagan is greatly weakened, and like Humpty-Dumpty will not be readily put together again, he will still be President for the next two years. He will still be capable of demagogy on issues such as taxation. He should have enough support in the Senate to sustain vetoes on economic issues. The Democrats will lose their momentum if they enact legislation that will result in sustained vetoes.

The events of November will be a prelude to success in 1988 if the Democrats emulate what Senator Paul Douglas did in 1959 and '60, which was to use control of the Congress to develop legislative initiatives for the future. ■

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

Interventions never take place in the same economy twice.

The unemployed, especially the young unemployed, are deprived of the opportunity to learn by doing.

ITU merges with CWA

After 134 years of independence the International Typographical Union will merge with the Communications Workers of America. Its members voted overwhelmingly by mail to become the Printing, Publishing and Media Workers section of the CWA. The headquarters will be moved from Colorado Springs, Co., to Washington, D.C., where space has already been prepared for the new section. The ITU has 40,000 active members and 30,000 retired members; it was the oldest labor organization in the United States and the oldest in the AFL-CIO.