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Is the Party About to End?

Hyman P. Minsky Ph.D.

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

By Hyman P. Minsky

On Tuesday, July 8, the *Wall-Street Journal* carried the head below as a sub-headline on its lead article, which dealt with the 3.25 percent drop in the Dow-Jones that had taken place the day before. While this decline is not in the same league with the 12.8 percent fall of October 28, 1929, which marked the start of the Great Depression, it does raise questions about the staying power of the Reagan prosperity. Is the stock market boom of the past nine months or is the economic expansion that began in late 1982 coming to an end?

It might be deliciously ironical if the second Reagan recession started immediately after the patriotic excess and exhibition of hubris that marked the July 4 weekend.

Stock market prices have outrun expected earnings. A stock market becomes speculative when its prices reflect a hoped for appreciation of stock prices more than a realistic expectation of the earnings of the enterprises. Expectations of appreciation certainly drove the stock market in 1986. An adjustment may be overdue; the Wall Street orgy of mergers and acquisitions could be ending, at least for a while.

The current expansion is more than three and one-half years old. The expansions that followed the 1969-70 and 1974-75 recessions were longer. Furthermore this has not been a normal expansion, for the rate of inflation—which usually increases during an expansion—decreased. Disinflation, the economists' label for this fall in the rate of increase of prices, may shorten the life of the expansion.

Even before the stock market break, many forecasters had abandoned their earlier views that a pick up in the rate of expansion would occur in the second half of this year, because they saw little buoyancy in demand. The last three quarters have shown modest rates of expansion, 0.7 percent, 2.6 percent, and 2.1 percent. The economy may well not have enough momentum to go forward without some new external stimulus.

A President is known as much by the people he appoints as he is by his own declarations. The economists who Reagan appointed speak of free

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The Reagan prosperity depends heavily upon the government deficit.

Some of the Council activities were partisan.

THE ECONOMY

from the not-so ivory tower

markets and are anti-Keynesian. However, when policies are examined the practices are "Keynesian" and interventionist. Since 1981, government deficits have served to maintain demand and Federal reserve interventions have prevented disarray in financial markets.

However, the policy has only been superficially Keynesian. In the Keynesian view deficits are desirable under special circumstances, such as when there is a war to be won or a recession to be overcome. But when the war is won or recovery replaces recession, the tax and spending programs in place are supposed to move the budget towards being balanced. Keynesian fiscal policy teaches deficits

spending item to the budget. We can all envisage a multitude of useful domestic programs that 57 billion dollars could fund.

One does not identify the Reagan time in office with socialization, but in 1984 the risk for depositors in giant banks was effectively socialized. Why would anyone in his right mind deposit substantial sums of money in a Texas bank that on a current liquidation basis has a substantial negative net worth? In such a bank, a depositor has a claim worth 80 cents for every dollar on deposit. The reason why sane investors deposit in these banks is that the deposits are not just the liability of the bank. They are also contingent liabilities of the Federal

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at the wrong time are inflationary and disruptive.

In Keynesian terms the recent deficits, which are mainly due to the President's unwillingness to tax, are undermining the financial structure by degrading the economy's best financial asset, the government's debt.

The cumulative deficits over 1981-85 have added more than 700 billion dollars to the Federal debt and more than 57 billion dollars to the net interest bill of the federal government. The Reagan policy of running massive deficits because of an unwillingness to tax has added a major permanent

Reserve System, The Federal Deposit Insurance Corporation and ultimately of the Federal Government.

By the letter of the law, deposits are insured up to \$100,000. Deposits over \$100,000 are presumably assets at risk in the sense that if the bank's assets decline in value, the deposit may be paid off only in part. For this to happen the losses must be greater than the equity account. It is undoubtedly true that for many Texas banks enough loans have stopped performing so that if the banks' assets were valued on a liquidation basis, the equity would be severely compro-

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the kind of visibility that Murray had. It was unusual to have two people of that kind of national visibility on the campus at the same time. I used to wonder about that when they had lunch at the same table at the faculty club. The knew each other well. There's been no effort on the part of anybody at Washington University to get rid of Barry Commoner or to influence faculty decisions on the basis of ideology or politics. That's just not what we do. You can say that we do them, people do. But I don't believe it. I never have believed it.

SJR: Does something like either one of those centers depend a lot on outside contributions?

DANFORTH: Oh yeah. Both Barry's did and Murray's does. Absolutely.

SJR: In the modern-day Washington University, where outside financing determines so much, is it still reasonable to say, with the plaque under the arch of Brookings Hall, "Those Who Come Nearest to Truth Come Nearest to God?" Or is it more like "Those Who Come Nearest to Outside Financial Interests Come Nearest to Success?"

DANFORTH: You may see Washington University in one way and I may see it in another. I don't know how you see it. But the university's job, I think, is to provide a certain support for the academic programs of the university. Some of those programs get a considerable amount of external funding. Those programs tend to be able to grow. Much of the external funding is for research, so they tend to be able to do more research along the lines where the external funding is. The university then has to worry a good deal not only about supporting those enterprises, but also about those enterprises that do not receive that kind of external support. They need to rely more on the traditional things: alumni giving, giving by friends, and that sort

of thing. The difference, I think, is not ideological. The medical school has a lot of outside funding. The law school has very little. That's traditional in American higher education. Law schools are much more dependent on student fees and on gifts for their income than are medical schools. One of the results is that medical schools tend to be somewhat larger than law schools in terms of faculty, but I think both have people in them who are pursuing academic freedom, seeking greater understanding, and publishing more. I don't think it depends on outside funding.

Outside funding is nice to have and certain things can be done with outside funding that you could not do otherwise. Murray Weidenbaum was here doing his thing before he had his Center for the Study of American Business. That has provided him with more outside funding for research and supported some other people in the university and so on. It may act as a magnifier for what's going on, but I don't think it changes what goes on in other areas. It doesn't detract from them.

SJR: As the U.S. economy has lost its dominance in the world, many people say that there should be more collaboration between business, universities, and government. One description of the way the Japanese do it is that the government gets in there and helps corporations and universities decide to put money together for one research program over here, and another over there, instead of everybody doing a little bit of many different things.

DANFORTH: I don't believe in that. I think directed research is very important. It's fine, but what we do in the universities, most of what we do, is closer to basic research, and that is really providing some very bright and able people with some funds to do the things they think need doing. I believe in that. That's a much better way to go for society in the long run. There are places that can carry out the other kinds of research. That can be done in corporations, it can be

done in commercial laboratories, and so on. That's fine, but I don't think that's the main mission of the universities. Ours is more basic research. We don't do directed research.

SIU-E

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opposes the form of the bill which, it claims, requires burdensome reporting procedures.

This year's agenda is being worked on, she says, and will only address issues that directly effect Southwestern Illinois economic development, and legislation which is actually considered by the Illinois House and/or Senate.

Critics also take exception to the SIUE's direct involvement in industrial development, such as University Park, which is strongly supported by SWILC.

OAD representing the University, was "involved in its stimulation," Koepke says. The project will be an office, research, possibly light industrial park which will be developed by state monies and will be on University land.

The benefits to the area would be new businesses and for the university the opportunity for student involvement in the firms, planners say. Not everyone agrees. Richard Keating, professor of biology, says the research park is not appropriate and represents a short-range attitude toward the use of the land which he maintains was intended to serve as a buffer between the University and commercial activities. One hundred years from now, it might be a much needed oasis or of use to the University itself, he adds. Another faculty member suggests that if the University cannot use the land it should sell it and not become a landlord.

The Council supported the completion of I-255 and, according to Earley, "steamrolled public opposition (to it). I-255 went through some of the best farmland in the world, the American Bottoms" and is an example of what Earley terms the Council's hyper-development strategy. The Leadership

mised or vanish.

In the collapse of the Continental Illinois Bank of Chicago in 1984, the Federal Reserve and the Federal Deposit Insurance Corporation provided sufficient refinancing on concessionary terms (terms that were not available in the market) so that all deposits were paid in full; the statutory \$100,000 limit did not apply. Furthermore because they feared that the Continental's disease might be contagious, officials announced that all deposits at the giant banks would be protected by the Federal authorities. In 1984, the Federal government effectively socialized depositor risk at the very large banks. This precedent of 1984 is keeping many of the giant banks viable even as the quality of their assets deteriorate.

The effective socialization of depositor risk in 1984 meant that the collapse of the Continental Bank did not lead to a recession such as usually follows financial disruption. Instead, 1985 and 1986 saw a stock market boom and a flood of junk bond financing. The socialization of depositor risk is the reason why the banks that are heavily exposed to energy, Texas real estate, and Mexico are able to market their liabilities.

The Reagan prosperity is heavily dependent upon the government deficit. However, the effectiveness of the government deficit as the basis for economy-wide demand is undermined by the huge trade deficit. So far, the decline of the dollar against the yen and the principal European currencies has not produced a turn around in the trade deficit. The best hope for prolonging the expansion is for the trade deficit to be greatly reduced. This does not seem to be developing very rapidly, if at all.

Whether the party of Reagan's prosperity ends or is prolonged in 1986, is not of earthshaking importance, except perhaps for short-run electoral considerations. What is of great importance is that the party is sure to end soon. When it does the shallow foundations of the free market and supply side analyses that underlies the Reagan approach will be revealed. Once that happens, we can move on to the development of a sensible system of intervention that is consistent with the realities of our times.

Council is "very effective and very powerful," he adds.

A 20-page promotional booklet, *I-255 Developmental Opportunities*, was prepared by Illinois Power Company with the assistance of Southern Illinois University at Edwardsville and lists the Leadership Council as the address.

One faculty member suggests building and developing are not necessarily good, long-range goals and that conserving resources might be a more important one.

Critics also find it objectionable that some of the Council's activities are political and as such are inappropriate for the University's involvement. Illinois Governor James Thompson was honored at a Leadership Council dinner this spring. Critics, including Earley, charge that in an election year a gathering praising a campaigning incumbent is partisan.

Leadership Council proponents and even some opponents agree that the organization has had an impact on the economic life of the MetroEast. The area, dependent as it has been on smoke stack industries, hard hit by the recessions, and sharply fragmented politically and geographically, probably needed a sense of cooperation and team work. The SWILC has addressed that need with some success.

But questions remain.

Does the pro-growth, pro-business Council represent only one vision of the area's future? To what extent are parts of the region left out of its vision? And further, how appropriate is a public university's support of the Council, especially if it does represent a special interest group? Koepke maintains that the OAD, the SWILC, and other programs are proving that the university can be an effective partner in economic development programs and that other universities are contacting SIUE to see what it is doing right. Critics see it another way. Some suggest powerful businessmen are trying to use the University, a tax supported facility, for their own purposes. The controversy may be just heating up.