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The Expected Short Half Life of Reaganism

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Even in the serious American press Reagan is being likened to Roosevelt as the architect of a major realignment in politics and policy. Reagan, his followers, and much of the press also argue that the policies of this administration will be a model--Reagan called it a beacon--for change in other capitalist welfare states. It is argued that just as Roosevelt's election in 1932 began a generation of Democratic party rule so Reagan's election in 1980 marks a sea change in American politics that will see conservative Republicans as president into the 21st century.

American myopia views European and other capitalist economies as followers upon what happens in the United States. Therefore the belief is widespread in the States that the Reagan example will be followed by the other advanced countries. To conservative America, the 21st century will witness a rebirth of 19th century capitalism.

A fundamental proposition that underlies conservative economic policy is that a modern capitalist economy can avoid great depressions without large and active government interventions. For the Reagan scenario for the rest of this century and the first part of the next to be valid this conservative proposition must be true not just in abstract economic models but also in the world as it is. If modern capitalist economies conform to the description of

Maynard Keynes rather than that of Milton Friedman the global rebirth of 19th century capitalism that Reagan is supposed to inaugurate will not happen. If Keynes was right Reaganism is here today, but it will be gone tomorrow.

Reagan's victories in 1980 and 1984 and his immense personal popularity do not prove that the American public has been converted to free market views. His victories were over very weak candidates. In 1980 Presiedent Carter was perceived to be a failed President. He was seen as being incapable of decisive action in the Tehran hostage crisis and as a failure in the oil crisis. Although the inflation rate was improving and the record of the economy during his time in office compares favorably with the Reagan years, Carter gave the impression of indecisiveness in economic policy. Americans find such weakness hard to tolerate in a President.

In earlier days, when strong local political leaders played a major role in candidate selection Carter would never have been nominated in the first place. If there had been strong state Democratic political organizations in 1980 he would have been denied the renomination.

Mondale was a good follower. He had never demonstrated public leadership. Except for the vice-presidency he had always been appointed to his major positions, then elected when he was running as an incumbant, an advantage in America. As long as Hubert Humphrey was alive to guide Mondale his lack of imagination and leadership was not evident. In American politics a president has to project a vision of a better world. In 1984 all Mondale offered was higher taxes without betterment: promising costs without prospective benefits does not win elections.

Thus recent history does not furnish evidence as to how a Republican conservative would fare in a presidential race against a personable Democrat who has viable prescriptions for evident ills of the economy. This candidate would need to articulate a well reasoned critique of the economy as it is structured after the Reagan years. He will need to put forth a program that gives promise of an appreciably better future. A successful Democrat cannot be a me-too candidate, echoing the Reagan advocacy of unbridled free market capitalism.

The Democrats in the United States and the left in Europe have a similar problem to confront. For the European left, with its Socialist background, the problem is "What do we stand for on economic policy, now that we have accepted capitalism, or at least the market economy?" For American Democrats who have never questioned the virtues of capitalism in the abstract, the question is "What is wrong with an unbridled market capitalism that makes government intervention in the economy necessary?" Both the European left and the American Democrats need to understand the flaws and fallacies of the Reagan-Thatcher-Chirac view of a capitalist economy before they can put forth a constructive program for the development of advanced capitalist economies.

Some Democrats, most particularily Governor Mario Cuomo of New York, have argued that the Republican vision of the economy leads to a society that is unfair; income and opportunity are not fairly distributed. Government intervention and the welfare state are defended as making the economy fairer. This unfairness view is supplemented by a vision of community and communal responsibility. In Europe, where the governing right aside from Thatcher is not especially concerned with dismantling the welfare system, the fairness issue does not hold. In America it has carried little weight.

The flaw in capitalism is deeper than its lack of fairness: the fundamental flaw is the instability of capitalism. This is not understood by American Democratic leaders; the case for intervention is much stronger than the fairness argument.

Thatcher's England may hold the key to economic policy for the "left". Thatcher's England even more than Reagan's America is a dismal failure in the generation of employment opportunities and the creation of resources, particularily human resources. Because of the parochial nature of the British labor party the opposition is ineffective. As a result Thatcher is able to go much farther in using unemployment as policy instrument than Reagan. It is clear from the British experience that the first prerequisite for a humane capitalism is full employment and that full employment cannot be achieved and sustained by a system of government that looks to "the market" for a sufficient number of jobs.

The institutional changes put in place in the United States during the reform era of the 1930's were not based on a consistent analysis of how a modern capitalist economy functions. Nevertheless the reforms of the Roosevelt era turned out to conform to the basic requirements for interventions that contain the tendencies for profits and asset values to collapse. The collapse of profits and asset prices are the economic developments that are critical for the emergence of serious depressions.

In 1986 we have evidence of the appropriateness of the system put in place in the 1930's that was not available earlier, for the various financial crises since the 1960's that could have led to deep recessions were contained and quickly reversed. The reforms of the Roosevelt era were apt by accident, nevertheless they laid the foundation for the most successful years of the capitalist epoch--the years between 1946 and 1967. Futhermore they have prevented the recessions since the late 1960's from turning into disasters.

The Reagan agenda, which because of the complexity of American politics has not been achieved, leads to an economic structure which would greatly weaken the stability of the economy. By allowing free reign to profit seeking financial manipulations and diminishing the size of the government the Reagan agenda would simultaneously increase the need for government deficits to contain the downside potential of profits and decrease the ability of government to contain the downside potential. The economics of Reagan does not recognize that without interventions by authorities to sustain profits and to maintain the viability of the financial structure, serious depressions are inevitable.

As a result of the cumulative changes since 1946, the financial structure of the United States and the rest of the capitalist world is now fragile. Many assets are valued not for the cash they are expected to earn but for their expected price appreciation. Any short fall of aggregate business profits is likely to lead to a wholesale need to restructure domestic debts and to a wholesale decline in asset values. As it is the civilian economy of the United States, if left to its own devices, would quickly sink into a deep recession. The massive military budget is providing the underpinnings to the tenuous Reagan prosperity. When the major expansion of the military is brought under control, the Reagan bubble will burst. If Gorbachev acquiesces (or forces) in comprehensive arms limitations, he will do more harm to capitalism by kindness than Communism has been able to achieve by being aggressive.

It is inappropriate to compare Reagan with Roosevelt because their Presidencies occurred at very different stages of the business cycle. Roosevelt took office when the American and world economies were prostrate from the great contraction that started in 1929 and continued until early 1933. Reagan is in office during an incomplete prosperity following a short and moderately severe recession. Roosevelt took office in the immediate aftermath of a great financial shakeout; both financial and capital asset prices had fallen to a small fraction of their prior values. Reagan is in office during a stock market boom and an immense build up of business and household debts. In terms of where their administrations are in the business cycle Reagan's position is like Coolidge or Hoover, rather than Roosevelt.

To understand how a capitalist economy works it is necessary to look at its financial structure and the sources of the money flows that are needed to fulfill contracts. If a capitalist economy is investing to put productive equipment in place or if income is being sustained by government deficits, then the cash flows to validate debts will come from the normal revenues of firms and the wages of workers.

There is another source of cash flows that can be used to meet financial commitments, the sale or pledging of assets. Many of the corporate mergers and acquisitions that are so prominent these days are viable only if capital assets or going firms can be sold at optomistic prices. A booming in the stock market is a necessary ingredient for the validation of the merger and take over boom.

The great success of the Reagon administration has been in halting inflation. This has occurred in spite of the enormous deficits and the rapid increase in monetary variables. The combination of a slow growth rate of gross national product and a rapid rise in stock market prices means that the ratio of corporate earnings to stock prices has decreased. When this happens the main reason for holding stocks shifts from the expected earnings of the underlying enterprises to the expectation (or hope) that the prices of stocks continue to rise.

Holding assets in the hope that prices rise is a bubble and such bubbles always burst, because eventually the return from holding alternative assets, perhaps money or near monies, becomes better than the prospective returns from holding assets that hopefully will appreciate. When such a break occurs, many takeovers and other highly levered financial positions will unravel, just as a knit sweater does when an appropriate thread is pulled.

Today the American economy is presumably prosperous. If we abstract from the impact of military spending the prosperity vanishes. Reagan's prosperity is a fiscally driven prosperity. The imbalance between government spending and receipts is what keeps the economy from sinking into a recession. Private investment, especially in productive capacity for civilian productions, is far too small to keep income and employment from collapsing into a recession.

Recessions occurred in 1969-70, 1974-75, and 1981-82. If the interval between recession is 5 to 7 or even 8 years then the next recession can begin any time from the second half of 1986 (now) to the end of 1989. If we look at the recessions since 1966 it is evident that each recession was more serious than the preceeding one. When the next recession occurs, and if the progression of seriousness continues, then the public support for the policy thrust that Reagan represents will collapse.

Thus there is a very simple reason why Reaganism and economic conservatism are transitory phenomena and why we will not have a generation of conservative rule. Capitalist economies do not behave in the way that the Reagan view requires that they behave. Instead of nicely seeking and sustaining full employment, capitalist economies are prone to generate serious recessions and depressions. These recessions systematically impoverish vast numbers even though the resources and skills exist which could provide for universal affluence.

With the next recession the dependence of capitalist prosperity upon government will be evident. At that time the question will not be whether government interventions in the economy are necessary, but what should the government do and for whom shall it do it. At that post Reagan stage the debate over economic policy will become really interesting.