COUNT DOWN TO NOVEMBER 1988

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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 the unreliability of right wing anti-Communism. As a result come January the Democrats have the opportunity to control the agenda that determines our public discourse. A great deal rests upon what is placed on that agenda. If that control is properly used the right wing conservatism that has plagued our times may be put to a long rest.

Theodore Roosevelt characterized the Presidency as a "bully pulpit". Reagan and his handlers were the most proficient users of the Presidency to control what was discussed and how discussions were framed since Franklin Roosevelt. By losing his credibility in November, Reagan will not be able to dominate the next two years. Credibility is like virginity, it can be lost only once.
Making Reagan credible again is as formidable a task as putting Humpty-Dumpty together again.

Will Rogers, the cowboy humorist of the 1920's and 30's, remarked that "I belong to no organized party, I am a Democrat". For the Democrats to regain the Presidency in 1988 they will have to give the lie to Will Rogers by developing a coherent perspective on critical policy issues. Come January the Democrats must show that they have adjusted to the needs of the last years of the 20th century, their agenda cannot be seen to be a rehash of the programs of the pre-Reagan era.

In spite of the collapse of the Reagan administration's foreign policy, economic issues will be the test of how well the Democrats use their control of the agenda. Over the past decade the Democrats have been on the defensive with respect to economic policy. Such defensiveness is unwarranted.

Democrats need to emphasise that the economy was more successful over the past 50 years than ever before and that it was the reforms of the 1930's through the 1960's that made this success possible. The decades of prosperity after World War II were not the result of unfettered "free market" capitalism. Economic policy needs to be based on understanding that the virtually unconstrained free markets of the 1920's led to the Great Depression of the 1930's and that the most remarkable economic fact about the forty years
since World War II is that the world has not suffered another major depression.

History demonstrates that only with appropriate government interventions and regulations does our type of economy work reasonably well. The Boesky affair on Wall Street shows the dangers of a lax regulatory environment. The main purpose of an appropriate system of regulation and intervention is to prevent or contain depressions and to facilitate resource creation. In a modern economy efficient resource creation requires that the financial system's integrity be maintained.

A depression free environment once created is a transitory affair, it involves an internal contradiction. In the absence of depressions liability experimentation is profitable. But liability experimentation leads to financial evolution which results in payment commitments that cannot be fulfilled without subjecting the economy to inflation. If the Federal Reserve takes measures to contain inflation then the financial strength of business and banks will be compromised so that the financial structure becomes fragile, i.e. it becomes crisis crisis. When a crisis seems imminent the authorities feel forced to bail out weak banks and even key businesses. Furthermore a taut and fragile financial structure means that the ability of the private economy to finance technical progress and resource creation is undermined.
The Democrats who make economic policy their specialty need to understand that a set of interventions that is appropriate in one economic environment is likely to become inappropriate as the economy evolves. The effects of government regulations and interventions change as people learn how they affect the economy. It is said that we can never swim in the same river twice. In a like manner we can say that interventions never take place in the same economy twice.

Principles, such as the need for interventions to contain the forces that make for big depressions, do not become obsolete, but specific interventions do. Democrats need to accept that some of the interventions and regulations that were put in place in the 1930's through the 60's were having serious undesirable effects in the 1970's. A new structure of intervention and regulation, that confronts the shortcomings of our economy that are now evident and whose initial undesirable side effects are minimal, is needed. The development of such a program 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 1960's, the Republicans can get off the hook.

The first item on the economic policy agenda should be to face up to the fact that, relative to Japan and Western Europe, the country is a much weaker economy now 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. As is evident from the continuing tragi-comedy of General Motors, there is something seriously amiss in our industrial structure.

Today's prosperity is truly a 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.

There are three glaring and obvious dimensions to our current economic weakness: The huge government budget deficit, the massive international trade deficit, and the 7% unemployment rate during "prosperity".

The budget deficit cannot be attacked without first determining the appropriate scale of government spending on defense and on 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 that 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. The preparation for true tax reform should be high on the agenda for the next two years.

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

There has been far too much finger pointing at labor costs as the cause of our international trade problems. It is now clear that management deficiencies and the monopolistic nature of much of our industry are major causes of the international trade deficit and the slow growth of productivity. The development of programs that foster truly competitive markets needs to be on the agenda.

The crime of 7% 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 unemployed, especially the young unemployed, are deprived of the opportunity to learn by doing. Chronic unemployment is a failure to develop human resources.

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. There is little doubt in my mind that a 1990's version of the New Deal's Civilian Conservation Corps will be an essential ingredient to a resource creation oriented 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 supportive of unions is needed. The government's support should be structured so that cost push inflation does not result from wage pressures due to the strengthened unions.

In 1958 the Democrats were in a similar position to what they are in now. 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. 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.

Although Reagan is greatly weakened, and will not be readily put together again, he will still be President for the next two years. He will still be capable of demogoging on issues such as taxation. He should have enough support in the Senate to sustain vetoes on economic issues. The Democrats should not try to take over economic policy by enacting legislation that will result in sustained vetoes. They should emulate Senator Douglas in 1958 and 1959 and develop programs for the future.

A thorough study of the American economy should be a major thrust of the Democrat's economic program in the next Congress. The aim of the study should be to uncover the reasons for our deteriorating performance and to develop policy initiatives to overcome our deterioration.

Much of the economic experimentation of the past two decades has come from the White House and from ideologues outside government. Economic reforms achieved in this way lack legitimacy; reforms gain legitimacy when they are developed in a thorough public study by the Congress. The most productive use the Democrats can make of their victory
of November and the disarray of the Reagan administration is to prepare for a new beginning in 1989.