Failed and Successful Capitalisms: Lessons From the Twentieth Century.

Hyman P. Minsky

Distinguished Scholar: The Jerome Levy Institute of Bard College

A talk prepared for the Jerome Levy Economics Institute Series at Bard College.

To Be delivered Nov 10, 1994

Introduction

There are as many varieties of Capitalism as Heinz has of pickles. This may account for the relative sucess of capitalism: it is like a bacterium meets a new antibiotic which for a time is effective but the bacterium mutates and the virus loses its effectivenss. Capitalism is a surviving economic system to the extent that it allows its institutions to change. When institutions are frozen, capitalism doesn't perform well: the citation may well the land tenure systems in Latin America.

There is an aside to the above which may account for the failure of the Lenin - Stalin Communism: it became frozen institutionally and could not adapt to the decentralizing force that came with modern communication and engineering. The freezing of a 1920's style of industrial plant, a style of plant which the capiitalist world no longer contemplates. There is a message in the Soviet failure which we should heed. Those who talk or write of a "true" capitalism as some non-interventionist form that is consistent with a sacred text, such as Adam Smith's Wealth of Nations or Hayek's The Road to Serfdom, and from this premise draws the conclusion that the observed failures of a real world capitalism are due to its deviation from a "true' model doesn't appreciate that market economies need a great deal of institutional infrastructure to work and this infrastructure evolves in response to gain seeking by the agents who make up the economy.

In thinking about the various forms of capitalism it is desirable to distinguish betwee small governmment laissez faire forms, in which government does not intervene, and big government - interventionist capitalisms. Among big government interventionist capitalisms I want to differentiate between those that are mainly populist and equalitarian and those that are repressive and defenders of an inherited political and social heirachy. We need to recall that the Fascist, Nazi and colonial regimes were capitalist as are today's Scandinavian countries.

As the twentieth century draws to a close we need to extract lessons from this century in which progress was inexorably intertwined with horrors and disasters. An exercise which aims at extracting lessons from history could deal with big questions such as the meaning of success and of failure, of progress and decline and whether a common morality exists and, if it exists, its significance. I am not going to try to extract lessons about big philosophical and moral questions.

I wish to limit or concentrate our vision on a narrower set of questions all dealing with the success or failure of economic structures. This grim century has seen the rise and collapse of the Soviet model of Socialism, which was an economic order based upon an extreme rejection of the use of markets to determine economic outcomes.

But earlier in this century, in the winter of 1932-33, the advanced economies based upon the use of markets were abject failures. One evaluating economies from the perspective of the mid 1930's would start from the observation that market economies "break down" and therefor conclude that there is a need to alter if not to abandon the market way of organizing economies.

However after the collapse that culminated in 1933, as well as during the first twenty five years after the end of World War II, a mighty recovery and expansion occurred in the United States and in the capitalist economies of Western Europe. However this recovery and expansion was of a model of capitalism which differed radically from the model of capitalism that collapsed in 1932-33. The welfare state capitalisms of the postwar period was a more successful economy than the largely laissez faire pre-war economy.

Beginning about 1968 to 1970 the successful welfare states began to run down. Some impute the decline to the oil shocks of the 1970's which led to a large transfer of wealth from the advanced and emerging economies to the oil producing states. Others, and I am one of the others, put more weight on the growing fragility of the financial structures of the capitalist economies. What was true was that the 1970's was a period in which the real growth of the principal capitalist economies slowed down and a decade of price level inflation began. The constraints of the Bretton Woods monetary system on the United States led to an abandonment of the Unted States of its core position in maintaining essentially fixed exchange rates. The "cure" for the inflation which followed upon the abandonment of the quasi gold standard and the multiplication of the price of oil was a regime of extrordinary high interest rates at the end 1970's and into the 1980's. This led to a set of serious recessions and a breakdown of the financial institutions that were based upon a pattern of interest rate stability which made long term debt financing a backbone of the housing of the United States.

This cursory summery of economic developments over this grim century indicates that history has much to teach us about the varieties of capitalism that existed and how they behaved. The early part of this century was a largely though not a completely laissez faire system. The middle part was in the United States a big government capitalism. The third part of the century was a period in which the success of the 2nd third was attenuated but which did not fall into anything like the disasterous performance of the 1st third. We need to extract from history ideas about what makes a capitalist economy a successful economy.

We can also extract from a reading of history some of lessons how about how the success of an economic system is linked to social and political developments. In order to do this I will emphasize developments in the United States with some asides upon developments in what are now the rich market economies. I will not deal with the abject economic failures of the African nations, both North and South of the Sahara, the chronic stop go progress of the Latin American economies, nor with the recent success of the Asian Tigers.

For the remainder of this century and the first part of the next the countries of Central and Eastern Europe will be occupied with creating capitalism. The rich Capitalist countries of Western Europe, the United States, Japan and some of the former British Dominions, will be occupied with trying to capture once again the glories of the period during which capitalism was a great success. This will involve reforming the current structure and in an effort to make Capitalism work once again as well as it did in the aftermath of the great depression. Now that the whole world is setting out to be Capitalist, the problems of the era we are entering will be to create capitalism, reform capitalism and make capitalism succeed.

Thus like Gaul for Caesar, the performance of the United States United State's economy during the 20th century is divided in three parts. The first part ran from the beginning of the century to the collapse of Capitalism in the winter of 1932-33. The second part runs from 1933 until about 1968 and the third part runs from 1968 until now. Similarly the political history of the United States falls into three parts.

The first third from 1900 until the election of 1932 had eight presidential administrations of which 6 were Republican and only two, the Wilson years, were Democratic. The second third running from 1932 until 1968 had nine administrations seven of which were Democratic. Only the two Eisenhower administrations were Republican. The third part of the century will have eight administrations of which we know seven: the split to date is five Republican and two Democratic tterms.

Capitalism was a abject failure in the winter of 1933, not only in the United States but also in the then developed economies. Although there were runs of good times during the first thirty three years of the century - the boom after the first world war in the United States being one of these runs - a serious depression took place in 1907 and around 1922. That of 1907 led first to the setting up of the National Monetary Commission and this in turn led to the establishment of the Federal Reserve System. The great contraction, which ushered in the crisis of 1933 that marked the virtual collapse of capitalism, took place between October 1929, when the stock market crashed, and March of 1933 when the banking system was shut down. Even aside from the great contraction the overall performance of the economy during this third of the century was mediocre: what prosperity there was poorly distributed and a succession of depressions racked the land. However the failure over the 1929-1933 period was well nigh unique in that all sectors of the economy suffered.

In many ways the literature about the Great depression catches the flavor of the collapse better than a mere recital of the statistics. We all know The Grapes of Wrath, in the film version if not in the novel. However the Oakies of the 1930's collapse were but the victims of just another farm crisis: A Grapes of Wrath could have been written of the era that led to Coxey's Army in 1894. The landmark William Jennings Bryan "Cross of Gold" speech of 1896 was a reflection of a crisis in agriculture.

To my mind Arthur Miller's play "The Price" captures the special property of the Great Contraction of 1929-33 in that its theme is how the Great collapse impacted the well to do along with workers and farmers who were the usual payers of The Price that the depressions extracted. The singular impact of the great contraction was not in the fall of output prices by about 1/3 or in the estimated 25%

unemployment rate: the extraordinary impact was upon the price level of assets. One representation of the price level of assets is the Dow Jones index of stock prices. By 1933 The Dow Jones was some 15% of its peak value: it had fallen by 85%. This fall in stock exchange prices values was associated with a massive decline in real estate values, the bankruptcy of "blue chip" railroads and utilities, so that payoff on bonds was at some fraction of their face value, and a rash of bank failures. These developments meant that an unprecedented impoverishment of the well to do took place. For them, who had been the main beneficiaries of the good times of the first part of the century, capitalism suddenly failed.

This first third which ended in the spring of 1933 was followed by some thirty five years which led to the United States being a roaring success, albeit that the political and economic hubris that this success bred led to the United States sashaying into intervening and defeat in Viet Nam. The last third of the century, starting from 1968 is still incomplete, but the indications for the performance of the economy is that nothing as severe as the debacle of 1929-33 is likely to happen but the performance is not up to the standard set in the middle third of the century.

We do not want to make too much of this division, but Democratic Administrations are associated with the transformation of failure into success and Republican administrations are associated with outright debacles as well as deteriorating behavior. Through much of the 20th century there is a difference between the two parties views of the economy. Republicans tended to reflect a faith in letting the markets determine outcomes whereas the Democrats reflect a wariness towards accepting the claims made for the market way of organizing economies. There is a difference in their views of how well the market economy functions if left to its own measures.

Full Employment in a Free Economy

This was the title given by Lord Beveridge to the book which contained his prescription for Economic Policy after World War: His definition of full employment was not in stated as a measured rate of unemployment at which point the analyst assumes that a further decrease in measured unemployment will lead to an unacceptable rate of inflation. Beveridges' definitionm of full employment was a market condition: At the ruling money wage the number of job vacancies had to exceed the number of unemployed. To Beveridge the aim of policy is to keep labor markets "tight".

The problem which the Beveridge conception of full employment leaves open is whether such tight labor markets would put so much upward pressures on money wage rates and thus on the money costs of production that unacceptable and accelerating rates of inflation would result. To present day economists the question of full employment becomes a question of the trade off between inflation and employment.

Employment policy during the first New Deal (1933-1936) era in the United States reflected two "ethical principles":

1. no one will starve in the United States, and in the normal course of events
2. income from work sufficient to achieve the no starving state will be available to all.

From 1 and 2 WPA, NYA, and CCC follows as principle devices to assure employment.

A Policy Agenda

This highly sstylized disaster, practical best or well nigh golden age, and deteriorating performance reading of the economic performance of the United States - and the other principal capitalist economies - during the 20th century can be interpreted fatalistically as the playing out off a long wave in economic life which is usually labeled as a Kondratiev cycle. However as the major driving forces of a capitalist economy

profits earned by owners of capital assets and

investments made by profit seeking enterprizes exploiting perceived profit oppertunities

are supplemented by government spending, in the form of transfer payments and the purchase of goods and services, and a favorable balance of trade. These complicating factors in the determination of profits mean that the way the century unfolded was not the inevitable outcome of economic forces. What happoned was the result of the particular twist given to the economic outcome by the manner in which the self seeking behavior of households, businesses and financial institutions interracted with the impact of government spending, taxing and the balance of the current account. A different pattern of government spending and taxation combined with a different pattern of the balance of trade would have resulted in a different incomes as well as a changed share of profits in income.

Government spending and taxing which play a large role in determining aggregate profits, has a shape, as determined by the nature of the tax system and the spending system. The impact of a given total of government spending (taxation) upon the performance of the economy will differ as the division of the spending among transfer payments (entitlements), the provision of service, and resource creation. To speak of fiscal policy in general misses the point that a given aggregate value result from a large number of different compositions and the overall impact of a "program" depends upon the details. If the definition of performance stresses employment and the development of the human beings of the society then the government spending should be aimed directly at human development and employment.

Historical Statistics of the UNited Stataes

year	GDP	Gov Debt	Per cent
	Millions of $		
1870	7,400*	2,436	32.9
1880	11,200*	2.091	18.7
1890	13,100	1,122	8.6
1900	.18,700	1,263	6.8
1910	.35,300	1,147	3.2
....			
1920	91,500	24,299	26.6
1925	93.100	20,516	22.0
1929	103,100	16.931	16.4
1930	90,400	16,185	17.9
....			
1933			
1935			
1940	95,400	50,700	53.1
1945	212,000	260,100	122.7
1955	265,800	256,900	96.7
1960	563,600	290,500	57.7
1965	702,700	322,300	45.9
1970	1010,700	380,900o	37.7
1975	1585,900	541,900	34,1
1980	2708,000	908,500	33.54
1985	4038,700	1,817,000	44.98
1990	5546,100	..3.,206,200	57.8
1993	6,374,000	4,351,200	68.3

What in truth can economists say about the market economy ?

Endogenous instability

The role of Investments as The Determinant of profits in the simplest case.

Government deficits and profits.

In a big government capitalism the ability of the government to run sizeable deficits can prevent the collapse of profits such as happened over the great contraction.

Government debt as a burden on fiscal measures

Need for the government's spending to abet economic expansion,

The exhaustion of investment opportunities.

Consumption vs. Investment in the government spending programs.