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TO: MARTH CID.
RUBENSTEIN ASSOC

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FROM: Hyman P. Minsky
Distinguished Scholar

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March 1933 / March 1992

March of 1933 is a watershed in our economic history. The financial system was bankrupt, industry was in disarray, agriculture was in revolt, and for many gainful employment was a distant memory. An enormous impoverishment had taken place since 1929: more than one third of the nation was ill fed, ill housed and ill clothed. The great contraction of the economy which began in October 1929 showed no signs of abating: economic chaos reigned. American capitalism was a failed economic system in 1933.

On Inauguration day in 1933 Roosevelt's clarion call "The only thing we have to fear is fear itself" marked an historic turning point in the economy. It expressed a will to create a new capitalism which would replace chaos with order and sustain an approximation to full employment. The institutional structure of this new capitalism was to include barriers that prevented a repeat of the debacle of 1929-33. Laissez faire - the doctrine of passive government and that the market always knows best - was repudiated. Henceforth economic well being was to result from the joint efforts of government, private enterprise, and popular organizations.

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The goals of economic policy during President Franklin Roosevelt's first term were recovery and ~~the creation of an institutional structure that would not be subject to great depressions.~~ ^{recovery} A ~~trial and error process~~ led to a big government capitalism that regulated finance and policed markets. ~~In time federal spending rose to the neighborhood of 20% of national income. Big government sustained personal incomes as well as business profits.~~

The reform measures of The New Deal may well have held back recovery. Nevertheless substantial improvements came quickly. By 1937 recovery was accomplished. A sharp but short recession took place in 1937.

After 1937 the new American capitalism, through war and peace, ~~sustained a rapid rate of expansion.~~ ~~For more than 30 years~~ American capitalism combined an unprecedented level of prosperity with a broad distribution of economic well being. The first ^{or so} 20 years after the second world war stands as a practical best for economic performance. ~~The reforms of the New Deal transformed capitalism from a failed to a successful economic system.~~ ^{had been transformed}

This successful capitalism was far different from the capitalism that led to the great depression. The New Deal had reformed finance, increased resource utilization, fostered resource creation, created safety nets for personal income and placed barriers in the way of downward price flexibility.

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Financial reforms eliminated the gold standard, insured deposits, compartmentalized banking and finance, provided for closer regulation and inaugurated transparency in both corporate finance and financial markets. Direct employment by The Civilian Conservation Corps, the National Youth Administration and the Works Progress Administration promoted resource utilization and created a safety net to personal income by making income through work available to all.

Resource creation took many forms: public works, rural electrification, TVA, other river projects, reforestation, land reclamation and public housing. Unemployment insurance, Social Security and government fiscal policies provided guarantees against a sharp declines in personal incomes and business profits. Agriculture price supports, minimum wages and government protected trade unions served as barriers against a free fall in the price level.

Stresses and strains in the New Deal structure became apparent in the 1970's. Strong and responsible trade unions, highly localized and narrowly focused savings and loan associations and effective anti-trust, which had contributed to the success of the 1950's and 1960's, diminished in importance.

The compartmentalized financial system, that was put in place in the 1930's, fostered enterprise and investment. Institutional evolution, such as the rise of pension funds, legislated changes, such as broadening the asset base of

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savings and loans, and mistaken policy, such as monetarism, along with new communication and computation technologies transformed the financial system. During the 1980's Cassino Capitalism took over: banking and finance made sure that enterprise was a bubble on a sea of speculation. It has taken a massive refinancing of the financial system by government money and enormous peace time government deficits to prevent the 1990's from replicating the disasters of 1929-33.

A strength of capitalism is that it is not frozen in stone: it can take many forms. As one form breaks down another develops, perhaps in the womb of the old. The era in which the Roosevelt era reforms did the job as an institutional framework for a successful capitalism may have come to an end in the 1970's. In the Reagan and Bush years policy has been guided by the laissez faire model, albeit with massive defense spending and huge government deficits. As in the 1930's policy guided by the laissez faire model has resulted in an impaired capitalism.

~~We need to create a~~ ^{in the 1980's} new interventionist model of capitalism if the American economy is to again perform as well as in the 1950's and 1960's. ~~A guarantee of access to~~ ^{no needed} income from useful work for all is essential. We should not think of putting an exact replica of the 1930's CCC, WPA and NYA in place: these 1930's mechanisms can only serve as prototypes. Greater Federal government financing of infrastructure investment and the creation of National

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research universities and institutes are imperative. A new Reconstruction Finance Corporation is required to recapitalize financial institutions and to assure that adequate financing is available for viable projects. The job related health care and pension schemes are now obsolete. *They need to be replaced by a universal health care system and by fully vested defined contribution pensions* It is imperative that the dependence on transfer payments for those fit to work be decreased.

The clear lesson from history is that a activist Federal government, which is a guarantor of full employment, a protector of the humane treatment of humans and a partner with private enterprise in the creation of resources, is a prerequisite for a successful capitalism.

In 1933 Franklin Roosevelt recognized that the disasters of 1929-33 were not due to a shortage of resources but to the ideological blinders which wedded policy to laissez faire. Since 1980, conservatives have foisted laissez faire upon the economy: this has opened the door to financial instability and deteriorating economic performance. Just as in 1933 the achievement of a sustained and widely distributed prosperity requires the casting off of the blinders of "the market always knows best".

of America is to me again more about a New Deal,

Hyman P. Minsky, The Jerome Levy Economics Institute, Bard College, Annandale on Hudson, NY 12504

March 10, 1992

*which substitutes listening to
to changes both the strength & the impact
foundations in how time has attenuated and
eroded that foundation -*