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Reconstitution

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need to be managed. The mangers of these funds presumably operate in the interest of the owners or the beneficial interests, but they also have interests of their own.

Thus we can distinguish four stages of interrelations between finance and firms in capitalist economies. We can label these as commercial, finance, managerial and money manger capitalism. Each of these types of capitalist structures obeyed quite distinct rules of development through time.

Money manager capitalism has a number of distinct features. The pension and mutual funds have monies for placement on a regular basis. They have outgrown the orthodox high quality stocks and bond portfolios of fiduciaries. They became a market for specialized instruments such as securitized mortgages, credit card receivables and lower quality, i.e. junk, bonds.

They also play a key role in the emergence of leveraged buy outs. A little known aspect of the leveraged buy out game is the leveraged buy out funds that each of the main players in the game controls. The source of the money in these pools available for equity position in buy outs is largely though not completely the various managed money pools. The emergence of money manager capitalism means that the financing of the capital development of the economy has taken a back seat to the quest for short run total returns.

V. Policy proposals

Aside from trivial features and the obvious need to refinance the bank deposit insurance function the administrations proposals are virtually dead on arrival at the Congress.

The Administrations recommendations address the emerging crisis in the banking system as well as the Federal financing of the validation of the deposit liabilities of Savings and Loan associations as problems that are due to specific institutional weaknesses in the banking system rather than any fundamental or deep seated flaw in market economies. In terms of the distinction between Smithian and Keynesian perspectives on the way the economy functions, the Administration's proposals are Smithian for they impute the problems to a minor flaw in the institutional structure rather than to basic characteristics of the economy.

The proposed reforms include the rather trivial matter of how the supervision of banks is to be divided between the Federal Reserve, the Treasury and a Deposit Insurer. Being a Treasury document the recommendations quite predictably are that the power of the Treasury should be augmented and that the Federal Reserve should specialize in something called monetary policy. The hypothesis is that monetary policy can be separated from any concern about the assets acquired by banks and other financial institutions. The recommendation about governance reflects a belief that banking and finance have nothing to do with the capital development of the economy. They do not address the

question of whether the financial system that will emerge after their reforms are in place will lead to our doing the capital development of our economy well.

Within the framework of the Keynesian view the main policy objective is to put a financial structure in place which is conducive to doing the capital development well. This is the criterion by which all policy proposals are to be judged.

A quick and dirty list of some policies that may well be needed if we are to emerge from the present crisis with a financial structure that will do the capital development of the economy well include:

1. Development of protection for early outstanding bonds when a major refinancing takes place. The junk bond phenomena was in part a transfer of value from existing debts to the new debts or the initial equity owners. The development of a right to put bonds whenever a serious change in the financial structure of the debtor takes place in a refinancing may be necessary. The doctrine of conveyance has to made to conform to current practices so that the use of managed funds for private gain is discouraged.

2. Need to question the pension fund system. Should policy induce a shift to defined contribution schemes? Should the power of pension funds be attenuated by having open ended IRA's? (No limit to contributions, withdrawals without penalty but all withdrawals taxed, interest and

dividend accruals not taxed except as they are spent.) Opening up the IRA's may well require a thorough overhaul of the income tax. Perhaps the income tax should be transformed into a spending tax.

Because it is desirable that there not be too many impoverished older people allowing for individuals to manage their own pension funds may well require that the Social Security System be opened so that the larger incomes will contribute and larger benefits will be available.

3. The government is no different than any other organization in that it needs revenues to validate its debts. This means that the government should have a normal conditions balanced budget, allowing for deficits in recessions and depressions and major wars. Inasmuch as a government that spends some 16% to 20% of GNP is more conducive to the normal functioning of a market economy than a government that spends some 3% to 9% of GNP, the tax system must be such that it yields 16 to 20 % of GNP when a close approximation to full employment is achieved.

4. Furthermore the government budget should be designed to have an automatic macroeconomic anti inflationary effect. Indexing as a mechanical device in social security and government pensions should be abolished, so that inflation leads to a substantial budget surplus.

5. Government spending should increasingly be directed towards the creation of resources and the creation of opportunities that enterprise can exploit. Better

coordination between the macroeconomic impact of government spending, the promotion of conditions that sustain profit flows. and the microeconomic impact of government spending, the creation of conditions conducive to private resource creation and progressive enterprise is needed.

6. In the presumed imminent refunding of banks and Savings and Loan Associations the government has been recapitalizing failed banks and S&L's without taking an equity position in the banks. The Hoover Roosevelt Jesse Jones Reconstruction Finance Corporation was a devise for equity infusions into organizations that were in principle viable but had been caught by non performing assets which were not performing because the aggregate economy was performing poorly rather than because the underlying project had been ill conceived.

7. One weakness of the banking system centers around the American scheme of paying for the payments system by the differential between the return on assets and the interest paid on deposits. In general the administration of the checking system costs some 3.5% of the amount of deposits subject to check. If the checking system were an independent profit center for banks then the banks would be in a better position to compete with the money funds.

8. Narrow banks, 100% money and other devices for loosing sight of the main object: The capital development of the economy. The key role of banking is lending or better financing. The questions to be asked of any financial

system are what do the assets of banks and other financial institutions represent, is the capital development of the economy better served if the proximate financiers are decentralized local institutions, and should the the stricture lean towards compartmentalized or broad jurisdiction institutions. In the United States this becomes the issue of the future of Glass Steagall.

When we go to the theater we enter into a conspiracy with the players to suspend disbelief. The financial developments of the 1980's can be viewed as theater: promoters, promoters and portfolio managers suspended disbelief with respect to where the cash would come from that would the projects being financed. Bankers, the designated sceptic in the financial structure placed their critical faculties on hold. As a result the capital development was not done well. Decentralization of finance may well be the way to reintroduce the necessary scepticism.

But more important than the details of where the economy is broke and needs fixing is the proposition that any program of reform reflects a model of the economy held by the champions of the program. It is my contention that the Smithian model of the economy fundamentally misspecifies the processes and the determinants of the performance of the economy and therefor any program of reform based upon its precept will enjoy but accidental and transitory success.