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Taxation

Once government is big, its tax take must be big and the structure of taxes will have a significant effect on relative prices, supply conditions, and financing practices. Given today’s military priorities and inherited commitments, spending by this Big Government will be dominated by transfer payments and military spending on goods and services. Of the spending by Big Government, the suggested employment and unemployment insurance will be inversely related to private GNP. A major portion of the profit-stabilizing deficits and the inflation-controlling surpluses has to come from variations in the tax take.

On the basis of our analysis, the standard classification of particular taxes as progressive or regressive has little merit. A sales tax is usually classified as regressive whereas a corporate income tax is considered to be progressive, but as our analysis of price determination showed, a corporate income tax will show up in product prices just as a sales tax. Similarly, the
employers' contribution to Social Security is a labor cost that must be covered by price. Whereas market interactions determine which prices carry the burden of corporate income taxes and Social Security taxes, policy decisions determine the proximate prices affected by excise and sales taxes.

Since any tax system that collects 20 percent of GNP will have some rates that hurt, a Big Government economy has to deal with tax avoidance and evasion. Tax avoidance, which is legal, is a modification of behavior that leads to a decrease or an elimination of the taxed activity. Tax evasion, which is illegal, is the nonpayment of taxes even though the taxed activity is carried out. Tax policy needs to consider the behavior modification aspects of tax policy and use the expected tax avoidance reaction to foster policy goals.

Most assuredly, all taxes have price-level effects. Excise taxes, corporate income taxes, value-added taxes (VAT) (total or partial, such as the employer's Social Security tax) tend to raise prices. Only the personal income tax tends to decrease prices by cutting demand, and even this tax may have some price-raising effect by reducing effort. Any tax system that seeks to offset inflationary pressures will have a progressive personal income tax as its centerpiece. Because a progressive personal income tax can be designed so that its yield is responsive to changes in nominal income, this tax can be an important stabilizer of prices as well as profits.
From our theoretical analysis it is evident that policy should aim at achieving and sustaining a robust financial structure. A key element in the robustness is the quality of the best available short-term asset—short-term government debt. An in-place tax structure that yields a surplus when the economy either does well on the income and employment front or poorly on the inflation front is a necessary condition for maintaining the quality of government debt.

Furthermore, as a financial structure is robust when hedge financing predominates, equity, which leads to no legally required payments, is the preferred instrument for financing business. A corporate income tax, which allows interest to be deducted prior to the determination of taxable income, induces debt-financing and is therefore undesirable. A corporate income tax also allows nonproduction expenses such as advertising, marketing, and the pleasures of the executive suites to be charged against revenues in determining taxable income. As advertising and marketing are techniques for building market powers and as "executive style" is a breeder of inefficiency, the corporate income tax abets market power and inefficiency just as the corporate income tax abets the use of debt-financing. Elimination of the corporate income tax should be on the agenda.

The achievement of an approximation to full employment is a major policy goal. As employer contributions to Social Security are a VAT on labor's contribution to value added,
tax avoidance leads business to substitute capital for labor in choosing production techniques. Inasmuch as capital-intensive techniques and the debt-financing by business to which it leads are destabilizing, the employer’s contribution to Social Security is a doubly pernicious tax, reducing employment and fostering instability. A universal VAT is superior to our partial VAT.

In an economy in which capital-intensive production methods are used, particular prices are, to a degree, arbitrary. Risk-averse bankers require the protection of borrowers’ market power before they finance capital-intensive production techniques. Therefore there are no serious price-efficiency arguments against the use of excise taxes to promote policy objectives. Substantial excise taxes designed to use the price system and tax-avoidance behavior to achieve social objectives could well be part of a tax program.

In 1983 the individual income tax, the individual contributions to Social Security, and the corporate income tax yielded 11.9 percent of the estimated full-employment GNP (see table 13.5)

The corporate income tax and the employers’ contributions to Social Security are, for the reasons stated, highly undesirable taxes. An income tax that integrates the corporate income tax and the employees’ contributions to Social Security should replace the present hodgepodge of income-based taxes.
Eliminating the corporate income tax leaves us with the problem of the use of a corporation as a tax-avoidance device. This is a problem that can be handled in a variety of ways. The analytically neat way would treat a corporation as if it were a proprietorship or partnership. This would require a full imputation of per-share income to the stockholders regardless of whether or not dividends were paid. Alternatively, and perhaps more simply, administratively the REIT provision—by which the corporate income tax remains on the books but corporations that pay out 85 percent or 90 percent of profits in dividends are tax exempt—could be generalized to all corporations. Either way, a unified income tax should be the major pillar of the tax system; it might be constructed so as to yield some 12.5 percent of full-employment GNP or more than 60 percent of the total collected taxes.

*TABLE 13.5 HERE*

As was mentioned earlier, we already have a VAT on the value added by those workers for whom corporations "contribute" to Social Security. This tax now yields some 2.9 percent of full-employment GNP; a comprehensive VAT to yield 3.0 percent or so of GNP seems a very modest revenue target.

Given that a penal tax on gasoline and/or oil is desirable to promote conservation and divert imports to non-
oil-producing nations, $108 billion or 3 percent of GNP (15 percent of the tax take) could well be raised by oil-related and other excise taxes.

The tax reform agenda addresses adequacy and structure. The tax program must yield enough to maintain the quality of government debt and allow swings in receipts to stabilize profits and constrain inflation. Political evidence indicates that the individual income tax cannot carry the entire burden of financing Big Government, and a serious program of VATs and excise taxes is necessary.

This tax program is different in kind from the Reagan tax reform package of 1985 and the various suggestions for simplifying the income tax that surfaced in Congress in recent years. Our program starts with the propositions that a government that is about 20 percent of GNP is needed to stabilize the economy and that the budget needs to be balanced when the economy is at or close to full employment. This means that if we use 1983 as a base and 6 percent unemployment as full employment, the tax system needs to raise 20 percent more income from a base line income that is some 10 percent greater than what ruled in 1983.

Because the income tax is part of a stabilization program, revenues should be sensitive to changes in income and prices. This argues for having a progression of tax brackets and rates over incomes in the middle range. Thus there should be more tax brackets than the President's 0, 15, 25, and 35 percent rate schedule implies. Because two
income based taxes, the Social Security and the corporate income taxes, are eliminated, the tax rates can be higher throughout the range than the President proposes, and substantially higher at very high incomes.

These suggestions for tax reform reflect the stability, employment, and price-level effects of various taxes. Equity issues, which are obviously important, are largely ignored. The basic point of taxation is simple; taxes have allocational and distributional as well as macroeconomic effects. A government can get the overall budget to serve the needs of stability, but because each tax has supply and price effects and induces avoidance and evasion behavior, the details may lead to perverse political and fairness results. Because the VAT and a greater emphasis upon excise duties are part of a package that reduces both perverse employer contribution to Social Security and corporate income taxes, the program might well improve distributional and allocation efficiency.

An Employment Strategy

Although stabilization policy operates upon profits, the humane objective of stabilization policy is to achieve a close approximation to full employment. The guarantee of particular jobs is not an aim of policy; just as with profits, the aggregate--not the particulars--is the objective.
The current strategy seeks to achieve full employment by way of subsidizing demand. The instruments are financing conditions, fiscal inducements to invest, government contracts, transfer payments, and taxes. This policy strategy for full employment that does not lead to instability, inflation, and unemployment.

The main instrument of such a policy is the creation of an infinitely elastic demand for labor at a floor or minimum wage that does not depend upon long-and short-run profit expectations of business. Since only government can divorce the offering of employment from the profitability of hiring workers, the infinitely elastic demand for labor must be created by government.

A government employment policy strategy should be designed to yield outputs that advance well-being, even though the outputs may not be readily marketable. Because the employment programs are to be permanent, operating at a base level during good times and expanding during recession, the tasks to be performed will require continuous review and development.

There are four labor-market aspects to an employment strategy:
1. The development of public, private, and in-between institutions that furnish jobs at a noninflationary base wage.
2. The modification of the structure of transfer payments.
3. The removal of barriers to labor force participation.
4. The introduction of measures that constrain money wages and labor costs.

The four aspects of the employment strategy are linked. If the massive income must be guaranteed for the current and potential recipients of such payments. If barriers to labor-force participation are removed, the jobs have to be available for those who are now free to enter the labor market. Constraints upon money wages and labor costs are corollaries of the commitment to maintain full employment.

Before sketching a program of government employment schemes and ways to constrain money wages in a full-employment economy, the modification of the structure of transfer payments and the removal of the barriers to participation in the labor force must be examined.

Transfer Payments and Barriers to Labor-Market Participation

The United States has embarked on a course that will lead to a major modification of the Social Security system. The legislation that forbids the involuntary retirement of workers before the age of seventy implies that, in time, either the benefit will be a variable that depends upon the age of retirement or beneficiaries will draw income from Social Security even though they continue to work. A barrier to labor-market participation, the constraint upon wage income allowed to Social Security recipients, is now
politically untenable. Moreover, because of compound interest and longer life expectancy, the retirement annuity income increases significantly even with short delays in the retirement age. Thus, flexibility in Social Security, if structured like a private annuity, will both induce labor-market participation and decrease the chronic pressures for inflationary increases.

The most significant status-tested transfer-payment scheme is AFDC. When AFDC was instituted in the 1930s the social norm was that women with children, especially young children, would not work. Legislation for the support of dependent children quite naturally reflected this norm, and eligibility was restricted to mothers who did not have adequate income. But today’s labor-market participation rates have made the sociological assumption of the 1930s obsolete.

AFDC, despite its importance, is a minor government program in support of children; the major program is the children’s exemption in the income tax, which yields a return that increases with family income. A universal children’s allowance should be substituted for AFDC, and this income should be part of the family’s taxable income. The level might well be at $75 per month of $900 per year. This will provide a net benefit for all parents and a substantial benefit to the working poor with large families. A universal children’s allowance means that AFDC can be
eliminated and with it the barrier to work. But for this approach to succeed, jobs must be available.

The Road to Participation: The New Deal’s CCC, NYA, and WPA

For income from work to be available to all, the demand for labor must be infinitely elastic over a wide range of labor types and geographical regions. At the same time, this infinitely elastic demand must not unduly decrease the supply of labor to other occupations and employers, creating upward pressure on wages. Furthermore the employer, while willing to hire all who offer to work, is not committed to hiring any particular number or workers. This can be achieved only by government-funded employment at wage rates that do not place upward pressure on private wages.

As the program offers jobs to all, it effectively sets a minimum wage. Once the power of Big Government to stabilize the economy against severe down turns is established, minimum wage legislation is an anachronism. A world with measured unemployment and minimum wages is internally inconsistent; an effective minimum wage program must guarantee that jobs are available to all at the minimum wage.

An employment strategy must deal with youth and adult unemployment as well as the provision of jobs for older adults. The instruments of an employment strategy can be identified by labels drawn from the 1930s: The Civilian
Conservation Corps (CCC), the National Youth Administration (NYA), and the Works Progress Administration (WPA). In the New Deal days these programs were viewed as transitory, but in the light of the inherent instability of capitalism and the chronic shortage of jobs, they will be conceived of here as permanent.

The CCC, the most popular job program of the Roosevelt administration, provided youths with and ordered and controlled living and work situation. They were not part of a training school; the learning that took place was by doing. A principal task in the 1930s was the maintenance and improvement of the national parks and forests. In the 1980s the CCC could take up where it left off forty years ago.

In the 1930s the CCC enrolled about 250,000 youths; today it might aim at a program of 1,000,000. The target group will be youths sixteen through twenty years of age. In essence, the program would be a means of transition from being in school to being at work.

The CCC should provide keep and a modest income. Some $8,000 a year could be budgeted per participant; some $3,000 in wages and $5,000 in keep and job support. This program will take some $8 billion or 0.22 percent of the 1983 full-employment GNP per year.

A million is some 5 percent of the roughly 20 million in the target (sixteen through twenty) age groups, a group with chronically high unemployment rates. The CCC of 1
million, or even one considerably smaller, will have a sizable impact on youth unemployment.

The problems of youth, especially of youth employment, so evident today existed during the Great Depression. The NYA was a response to these problems. Like its predecessor, a resurrected NYA should take a number of forms because of the varied problems of the young. The basic target population should be sixteen to twenty-two years of age, in and out of school, as well as those in school who are somewhat older.

The NYA should provide jobs which will enable the children's allowance to be dropped at the sixteenth birthday. It should provide work-study employment for high school, college, and university students. These jobs would simultaneously aid colleges and universities by paying for necessary work in and around the institutions. It should also provide jobs for out-of-school and summer employment. The NYA out-of-school and summer employment might well provide training.

There are seven age cadres in the target population (the target population overlaps with that of the CCC) or some 24 million. The program should mainly pay for the labor costs of participants; the schools, colleges, and government units that use the labor will supply the material, supervision, and administration. At an average of $3,000 per recipient, a program level of 0.5 percent of full-employment GNP $18 billion in 1983, will employ some 6 million or 25
percent of the target population. Because of the overlap in target groups, NYA and CCC together could affect almost 30 percent of the target population.

The NYA should be a major resource-creation effort by the government. Ever since the Kennedy administration various schemes have attempted to induce economic growth and full employment by inducing or subsidizing investments. But ever since inducing investment has been a major policy objective, the growth, employment, and stability characteristic of the economy have deteriorated.

The war on poverty was a poorly conceived attempt that in part focused on creating resources by training target populations. While the NYA will have income-maintenance aspects, its main purpose will be to support the development of human resources and the institutions that produce developed human resources.

The WPA will provide jobs in lieu of adult welfare and extended unemployment insurance. Welfare cannot be eliminated unless something is put in its place. Jobs can replace welfare, however, only by an open-ended employment scheme. Since a full-employment economy is an unknown exotic environment, there is no way of really knowing how many welfare recipients, presently measured unemployed, and those out of the labor force will sign up for WPA jobs. In addition, to facilitate the reform of Social Security by allowing a recipient to work, the WPA effort should provide full- and part-time jobs for older workers.
Any estimate of the size of a WPA that would employ all comers when the economy is functioning well, especially as WPA will replace the existing welfare programs and will be available to supplement Social Security, is an act of faith. If we exclude youth unemployment, which CCC and NYA will attack, assume that thirteen weeks of unemployment insurance will continue to be available, and use a private-employment target that yields a 6 percent unemployment rate, some 2 million on WPA at full employment seems an ample first estimate of its scope. If some $7,000 per year is set as the wage of a WPA worker and $3,000 is allowed for overhead and materials, a WPA program for two million workers will cost $20 billion, or .055 percent of GNP.

In principle WPA should not be means-tested. Furthermore, because it will provide supplementary income to older adults as well as income for women with childcare responsibilities, the WPA might well have a mandate to develop part-time work programs.

It is envisioned that WPA, NYA, and CCC when fully developed will, together with normal government activity and private employment, provide income through jobs for all who are willing and able to work. These permanent jobs will provide outputs—public services, environmental improvements, etc. that a transfer-payment government does not yield, as well as the creation and improvement of human resources. In our urban centers, where there are concentrations of unemployed and welfare recipients, the improvement of the
public environment should be marked. WPA, CCC, and NYA will succeed precisely because they are job programs that perform useful tasks and yield visible outputs.

Money Wages

The standard analysis of the relation between money wage rate changes, price-level changes, and unemployment is based upon an assumption that a decrease in unemployment is derived from an increase in demand for goods and services. This implies that increases in employment will follow upward pressures on prices.

In the current policy strategy, an increase in unemployment leads to increases in government inducements to private investment and transfer payments, a decrease in tax rates, and an easing of financial-market conditions. The impacts of current policy strategy follow a path from a rise in aggregate demand to a rise in particular demands to a rise in employment; this path is conducive to price and wage increases.

Once the shift to an employment program has been assimilated, cyclical variation in employment will be replaced by variations in the proportion of workers on WPA. When demand for labor by private employers increases, the proportion of workers on WPA will decrease. With WPA, a fall in aggregate demand will not be turned around by increasing inducement to invest, increasing the money supply, or
lowering tax rates. Because labor demand and wage income at a low hourly scale are central in this policy, its inflationary potential will be less than that of current policy.

The employment strategy will lead to tight labor markets, but as WPA wages are to be significantly lower than in private employment, the supply of labor to private employers will be infinitely elastic as long as WPA employment is positive. Under these circumstances, market and institutional factors are not likely to give rise to chronic and even accelerating pressure on wages.

Under current policy, aggregate demand is sustained by increasing the inducements to invest and transfer payments. Policy endeavors to maintain the demand for labor that produces investment output. This sectoral emphasis leads to an accretion of market power by the producers of investment of goods and their workers (construction and machinery workers), which leads to higher wages and thus higher markups in consumer-goods production. The current policy strategy, first brings about a rise in markups and then a rise in money wages in consumption-goods production.

The employment approach has a lower inflationary potential than the present course. In a WPA, CCC, NYA strategy the pressures on money wages through induced investment demand and easier financing terms will be minimized. The base WPA wage should be rarely changed. If unemployment increases because wages in private employment
are pushed up by trade union pressure, then the supply of
workers to WPA will increase and the budget deficit will
rise. If the wage in the WPA employment program stands fast,
however, the money wage increases in private employment are
likely to be undone by market competition; the differential
between private and WPA wages will tend to be market-
determined.

Of course, a policy that the WPA wage should be some
ratio to the average wage could make an employment strategy
a handmaiden of inflation. If the policy aim is wage
stability and gradually falling prices that reflect
productivity increases, the WPA wage, as well as wages in
normal government employment and in military contracts,
must not rise in response to mild and transitory
inflationary pressures that reflect normal cycles in private
investment and employment.

**Financial Reform**

The history of capitalism is punctuated by deep
depressions that are associated with financial panics and
crashes in which financial relations are ruptured and
institutions destroyed. Each big depression reformed the
institutional structure, often through legislation. The
history of money, banking, and financial legislation can be
interpreted as a search for a structure that would
eliminate instability. Experience shows that this search
failed and theory indicates that the search for a permanent solution is fruitless.

In a Big Government capitalist economy with an active central bank, debt deflations and deep depressions can be contained. Furthermore, central bank administrative actions and legislation can attempt to control and guide the evolution of the financial structure in order to constrain cyclical instability. In our economy the financial structure can be said to begin with the financing of investment and positions in the stock of privately owned capital assets. As, by and large, business corporations control capital assets and order investment output, the financial powers and practices of corporations are the starting points for policies to manage or contain instability.

The Federal Reserve was organized to control instability. Inasmuch as the Federal Reserve system now intervenes whenever a serious debt deflation threatens, the Federal Reserve must broaden its scope and take initiatives to prevent the development of practices conducive to financial instability. The Federal Reserve has to be concerned with the effect upon stability of the changing structure of financial relations. This definition of responsibility stands in sharp contrast to the hands-off policy with respect to financial usages and institutions that the Federal Reserve has typically followed. The Federal Reserve needs to guide the evolution of financial institutions by favoring stability enhancing and
discouraging instability-augmenting institutions and practices.

Financial reform can be effective only as part of a general system of reform. As long as the main proximate objective of policy is to encourage investment, institutions, and ways of doing business that facilitate investment financing and capital-asset ownership will be fostered. But inappropriate financing of investment and capital-asset ownership are the major destabilizing influences in a capitalist economy. Thus, the substitution of employment for investment as the proximate objective of economic policy is a precondition for financial reforms that aim at decreasing instability.

The policy problem is to design a system of financial institutions that dampens instability. While banks are the central financial institutions of a capitalist economy, banking is a business encased in myth: it is an economic mystery wrapped in an enigma. Bankers are fiduciaries who advise and act in the interest of clients, even as their own income depends upon the services they sell to these same clients. Lines were drawn among commercial, investment, and savings banks aimed at moderating the conflict between the fiduciary and private-profit aspects of banking. Recent experience shows that the institutional lines cannot be sustained when there are large profit opportunities from breaching the lines.
Ordinary Corporations as Financial Institutions

Because corporations own most of the economy's capital assets, they collect most of the gross capital income, which is then apportioned by law and the liability structure to taxes, debts servicing (principal and interest), and gross equity income. Equity income may or may not be retained by corporations. Corporations are financial institutions that have special powers enabling them to collect equity funds from a large number of units and to go into debt. Corporations, by limiting the liability of stockholders, make the divorce between the ownership and management of business possible.

Since corporations can go into debt in their own name and not as agents of their owner, Corporations facilitate investment and the use of large-scale capital-assets. As Keynes pointed out, "The Stock Exchange revalues many investment every day and the revaluations give a frequent opportunity to the individual (but not the community as a whole) to revise his commitments. It is as though a farmer...would decide to remove his capital between 10 and 11 in the morning and reconsider whether he should return it later in the week"3 Once corporations dominate in owning capital assets and stock exchanges exist, the holding period of investors can conform to their changing needs and

preferences even though the corporation’s commitment to the ownership of capital assets can be for their expected productive life.

If capital assets are cheap, so that those needed for a business or trade can be easily acquired, then simple proprietorships or partnerships will do. Once capital assets become expensive and the expected profitable life exceeds the life expectancy of a mature individual, only corporations with their perpetual life can have holding periods that match the useful life of capital asset.

There are two classes of capital assets. One is like agricultural or urban land—the assets can be used for a wide variety of products, and there are many who are capable profitably using assets can be used for a wide variety of products, and there are many who are capable of profitably using assets. The assets have a price or value independent of the particular owner or user. Moreover, because they generate cash in an impersonal way, these assets are suitable for mortgage financing, that is, for financing tied to the asset rather than to an owner. Assets that flow through the production process and the channels of commerce (inventories) are also suitable for to-the-asset financing, as the funds to meet the debt will be obtained when the inventories are sold, i.e., are almost in sight when the financing takes place.

For both long-life general-purpose assets and short-life commercial assets that are fit for to-the-asset
financing, the payment commitments on the debts used can be closely related to the cash flows that these assets are expected to yield. The financial flow relations are analogous to those that characterize hedge financing.

The other class of capital assets consists of plants and equipment with no significant value outside of particular uses. As they can generate cash flows only if they are used in a small set of production processes, they have no or little value except to firms that use these processes. These capital assets are not suitable for to-the-asset financing. The debts used to finance such special purpose capital assets must be of the organization that owns and operates the capital assets. If the period over which the asset is expected to yield cash exceeds the life expectancy of a representative proprietorship or partnership, then the ownership of such capital assets cannot be hedge-financed by a proprietorship or partnership. If such capital assets are to be used, either the principal's personal funds must finance ownership or the financing must be speculative. Hedge financing is possible only if the time to maturity of liabilities can be of approximately the same duration as the period over which the asset is expected to yield cash.

The corporation is a social instrument that is best suited to hold and operate expensive special-purpose capital asset whose expected life as an earner of quasi-rents is long. Often corporate debts are not tied to the profits that
any specific capital asset generates: they are mainly tied to the earnings of the organizations and therefore are like a to-the-person loan. Given that the use of capital assets with overlapping life expectancies is required, a corporation operating special-purpose capital assets must have an infinite life.

If corporations did not exist, debt-financing of long-life special-purpose capital assets would have had to be speculative: the term of the debt would be shorter than the expected rent-generating life of the asset. By issuing long-term debts corporations can achieve a hedge-financing liability structure—this can help to stabilize the financial structure.

But the corporate form or organization facilitates the divorce of financing from the ownership and acquisition of particular assets. If short-term debts are less expensive, corporations that borrow on the basis of their overall profitability are able to finance their short-term assets. While corporations can be said to have begun as a vehicle for hedge financing of expensive, special purpose, and long-lived capital assets, the ability of corporations to issue debts that are not tied to specific asset means that corporations can borrow short to hold long assets. Consequently, the corporation, initially a device for extending hedge financing to long-lasting capital assets, can be a vehicle for speculative finance—and because it
facilitates both capital-intensive modes of production and speculative financing, a destabilizing influence.

Thus, there is an inherent constitutional weakness in the financial structure. One part of the weakness is technologically based: the use of expensive capital assets with long lives is best financed by instruments that are amortized over a long term. The second part is preference-determined: asset holders want to control their holding period, the corporation is a device for handling the financing problems due to technology. But because corporations have a perpetual life, the preference problem leads to the need for a market in which individual holdings can be transferred. Accordingly, a stock and bond market is a necessary adjunct to the corporate form of organizing business. But such a market opens the door to the speculative financing of perpetual liabilities (equities) by the short-term debt of stock owners.

The corporate form eliminates the constitutional weakness due to the incongruence of the life expectancy of adults and of plant and equipment. The corporation cannot, however, eliminate the constitutional weakness arising from the preference of wealth-owning households for assets with a potential for short holding periods. Furthermore, this constitutional weakness is strong whenever the demand for financing is high and rising rapidly because short-term financing markets are better able to respond by devising new instruments and new institutions; rising interest rates
yield losses to holders of long-term financial instruments, which closes down the long-term market. As a result of these constitutional flaws, speculative finance and the growth of market institutions that facilitate the rolling over and refinancing of positions are destabilizing developments during prosperous times.

The cash flows that validate business debts and determine the market value of liabilities are the difference between corporate total revenues and the cost of labor and purchased materials. Many corporations are tax farmers, in the sense that their selling prices are determined by the cash flows needed to validate debt (just as taxes are set by the need for revenue). The determination of prices by the need for cash flows requires that market restraints should be slack; monopoly or near monopoly market positions are often a Prerequisite for borrowing. As has been shown, Big Government prevents a downside collapse of the mass of profits that are available, and market power, often because of regulation, leads to protection of unit markups for particular users of capital.

Thus, if the expected cash flows of a firm with market power are insufficient to validate debt and serve as a basis for financing expansion, the firm will raise markups and prices. Because prices especially of regulated firms are usually lower than the unrestrained profit-maximizing monopoly prices, a rise in prices will lead to an increase in total profits. However, there is a possibility that the
price will go above the monopoly price, so that the net revenues do not rise or even fall. When this happens for a giant firm, government intervenes by means of subsidies, special tax credits, overt endorsements of debts, and steps to increase the flow of aggregate profits. The primacy of profits and debt validation as policy goals is evident in the behavior of government in recent periods of crisis.

Because the investment decisions of many organizations are validated by revenues resulting from private taxes, these investment decisions are like public decisions. Each brain scanner purchased by the hospitals, for example, shows up in Blue Cross and Blue Shield rates, which are a cost of labor to employers that must be covered in product prices. In essence, we have a tax-supported medical system in which taxpayers have no voice in determining the supply price of the service. The United States has a type of contingency socialism, in which the liabilities of particular organizations are protected either by the overt government intervention or by the grant of monopoly price-setting powers.

Financial reform needs to confront the public nature of much that is private. Big or giant organizations carry an implied public guarantee (i.e., contingent liability) on their debts. This introduces a financing bias favoring giant corporations and giant banks, for the implicit public liability leads to the preferred market treatment. Government intervention to validate the cash flow
commitments takes place even if investments are inept. One way the government intervenes is by generating a massive deficit. But these massive deficits are a basis for later inflation even as threats of private defaults are a basis for unemployment.

Because a large government implies that a profit-sustaining deficit will take place whenever income and employment falls, there is no need for policy to foster market power that protects profits by sustaining prices in recessions. In a world with Big Government, the individual bankruptcies can be tolerated because they cannot lead to wholesale defaults. Thus, bankruptcy, which transforms a nonsustainable speculative or Ponzi financing structure into a sustainable hedge structure, should be made easy and cheap. Once bankruptcy is simplified, the inflation-constraining forces of competition are free to operate. If an economy is to be open to bankruptcy, no organization can be so large that its bankruptcy is politically unacceptable.

Furthermore, to decrease the instability-enhancing power of corporations, the bias favoring debt-financing due to high-rate corporate income taxes must be removed; the corporation income tax should be eliminated. In addition, short-term corporate debt should be to an asset, not to the corporation. Bank lending to corporations by way of documented loans and open-market lending to corporations by means of documented acceptances—where there is proof that a short-term flow through asset is being financed—must be
encouraged. Such instruments should be given a special place in the process by which the Federal Reserve determines the cash base of banks and acts as a lender of last resort; that is, the Federal Reserve must stand ready to participate, through the discount window, in such financing.