



# *Policy Note*

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## THE CONCERT OF INTERESTS IN THE AGE OF TRUMP

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Before it became associated with support for isolation from the emerging European conflict in the 1930s, the phrase “America First” was used by Franklin Roosevelt during his first election campaign in 1932. President Herbert Hoover had been reluctant to deploy direct government support for the growing masses of the unemployed (although the support was more extensive than most give him credit for) for fear of interfering with the operation of the market mechanism that he believed would produce a recovery from what was presumed to be a temporary cyclical downturn: prosperity was “just around the corner.” When this recovery did not occur as expected, foreign financial and political events were blamed for eroding confidence. For Roosevelt, Hoover’s policy implied that “farmers and workers must wait for general recovery until some miracle occurs by which the factory wheels revolve again,” but “no one knows the formula for this miracle” (Lindley 1934, 40). By contrast, Roosevelt argued in favor of direct measures to “restore prosperity here in this country by re-establishing the purchasing power of half the people of the country [. . .]. In this respect, I am for America first” (40).

Instead of the miracle of a spontaneous market recovery, Roosevelt promised to take action to defend the condition of the “forgotten man” by offering him a “new deal” to protect him from

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the ravages of bankers and industrialists. The simple substitution of “making America great again” for “new deal” suggests an important similarity, at least in terms of the rhetoric and target audiences, between the first Roosevelt campaign and that of candidate Donald Trump. And in both cases, campaign promises created expectations that appropriate actions would be forthcoming. We know from history how Roosevelt proceeded by experimentation, by trial and error, with what at the time were considered audacious, radical policies (Kregel 2016). The question before us is how experimentation by the new administration may be directed to fulfill its broader campaign promises to this age’s “forgotten” men and women.

What was audacious about the New Deal was not its specific measures to restore the purchasing power of farmers and workers (which only fully emerged as policy proposals after Roosevelt entered the White House), nor was it the organization by the federal government of the various alphabetized institutions to implement these measures—rather, it was the recognition and acceptance of the fact that the federal government bore responsibility for ensuring the economic well-being of the population. The New Deal represented a fundamental change in the role of government as a permanent actor in the economy. In a phrase suggested to Roosevelt by Rexford Tugwell, the role of government was to coordinate economic activity in order to reconcile diverse individual objectives in a coherent “concert of interests” (Tugwell 1968, chapter 5)—what John Kenneth Galbraith’s gifted pen would call “countervailing power” (Galbraith 1952).

This change was not driven by ideology—it is not clear that Roosevelt had much in the way of a developed economic ideology (although he was religious)—but was based on the recognition that the economic structure that had emerged from the First World War was no longer composed of independent individual producers competing in free markets, but rather of increasingly large corporations that dominated markets through Schumpeterian innovation, producing monopoly power as the normal state of affairs. In contrast with Teddy the Trustbuster and the Progressive movement, the New Deal recognized the crucial role of the organizational ability of big business in increasing productivity, as well as the need to channel it to improve the conditions of the working man. Acting according to individual interests no longer guaranteed the greatest good for the greatest number, since the price system in competitive markets was no longer the basic principle of organization

and distribution. In that context, the problem was how to ensure that the organization of the new productive structure would achieve socially and politically acceptable results. The driving force here was more Thorstein Veblen than John Maynard Keynes, although it is perhaps easier to understand the point in terms of the circular-flow charts that were common at the time: firms’ labor costs are the source of household incomes that drive firms’ sales and profits. The government was no longer to be the disinterested referee of classical liberalism, but would have to become a player to ensure the results promised by innovation under free enterprise were enjoyed by all.

It was not only the changing domestic economic structure that required a reconsideration of the role for government. The New Deal represented the democratic alternative, the “third way” of its time, seeking a political model that avoided both the fascist and communist solutions—which at the time appeared to be the most successful responses to the Great Depression and had substantial domestic political support. Not only was this role for government radical in the context of existing economic theory, but also as a response to the authoritarian alternatives.

Those defending the traditional system quickly cast the conductor’s score for the proposed “concert”—eventually embodied in the 1933 National Industrial Recovery Act—as a “national plan” imposing centralized directives that would void the operation of the free enterprise *laissez-faire* system upon which the great nation had been built. Indeed, most of the New Deal was built on executive orders creating new agencies to produce regulations designed to coordinate the opposing interests of labor and industry.

Calls to eliminate regulations and agencies in order to liberate free market initiatives—what in current discussion is called the “dismantling of the administrative state”—were already present in the period. The central criticism of the measures taken in support of the forgotten man was that they were being taken by the government. Rather than make the more positive Hayekian argument that managing the consequences of the changed and changing economic structure might provide the best way to avoid the “road to serfdom,” critics argued that the New Deal approach suffered from a “pretense of knowledge.”

But as Walter Lippmann pointed out in *The Good Society*, written in the throes of the developing New Deal, this criticism of the New Deal is based on the same error committed by those liberals who adopt John Stuart Mill’s conclusion that “*laissez-faire*, in short, should be the general practice: every departure

from it, unless required by some great good, is a certain evil” (Lippmann 1943 [1937], 186). For Lippmann,

the whole effort to treat laissez-faire as a principle of public policy, and then to determine what should be governed by law and what should not be, was based on so obvious an error [...] in thinking that any aspect of work or of property is ever unregulated by law [...]. In a community there is no such thing: all freedom, all rights, all property, are sustained by some kind of law. So the question can never arise whether there should be law here and no law there, but only what law shall prevail everywhere. (186)

He goes on to make the point that the defense of regulations that preserve laissez-faire soon impedes freedom, since it presumes the prevailing social order is the only one that can be truly progressive, leading liberalism to become “a philosophy of neglect and refusal to proceed with social adaptation” (208). To Lippmann, the aim of the “true liberal” must be to provide regulation that resolves the social problems created by changes in the productive structure of the economy—by “the whole unresolved task of educating great populations, of equipping men for a life in which they must specialize, yet be capable of changing their specialty”—and to provide support for those who “do not adapt themselves easily” (Lippmann 1943 [1937], 212).

Thus we can give credit to the new administration’s campaign for identifying a major problem facing a substantial share of the working population, while at the same time expressing doubts about whether it has recognized Lippmann’s “obvious error”—that simply eliminating regulations and reducing the role of government to provide individual freedoms for particular groups could remedy the secular stagnation from which they suffer.

We must also recognize that Roosevelt was a convinced budget balancer (see Kregel 2016). Recall that Ronald Reagan channeled Roosevelt in his first campaign, only to follow Roosevelt’s recantation by creating ever-increasing budget deficits in his efforts to provide for a “sunrise” economy. This is just another aspect of Lippmann’s “obvious lesson” that has not been learned. Reducing the size of government in order to achieve the Trump campaign’s promises to aid the US worker is no more adequate than reducing regulation. Indeed, one of the major reasons for the secular stagnation we currently face is the failure of government to take on the responsibility of providing

the budget stimulus necessary to support household purchasing power in the aftermath of the recent mortgage crisis and accelerate the subsequent recovery. The current recovery is exemplary in being historically slow, but it also stands alone as the only postwar recovery in which the contribution of federal support has declined (Nikiforos and Zezza 2017).

And it is important to remember that besides the failure of Hoover’s promised “miracle” recovery, there was not only a lack of purchasing power, but a maldistribution of purchasing power, which was a major theme of Roosevelt’s 1932 presidential campaign.

As the campaign progressed, the European financial crises and the decisions of the major European countries to drop the gold standard became the favored culprits in explaining the failure of the miracle of recovery to appear (the “confidence fairy” was already present in the 1930s). On April 18, 1933, Roosevelt gave his approval to the Thomas Amendment to the Agricultural Adjustment Act (see Lindley 1934, 110), which gave the President the ability to take the United States off the gold standard—something he eventually did June 5th of that year. Note the important addition to the powers in the Thomas Amendment: the suspension of the gold clause in private contracts. Roosevelt had been careful not to promise to maintain the gold standard, but his pledge to maintain a sound currency was so interpreted, and this action eliminated any support for the New Deal in financial circles, as the suspension clause cemented the beliefs of those who thought that the President had taken on dictatorial powers.

We finally come to the problem of foreign trade and foreign policy, which was as disputed then as it is today. Here also the influence of the new structure of production is important, as the interests of agricultural producers seeking foreign markets for their surpluses met the protectionist interests of manufacturing. It makes little difference if the reference is to Say’s law or Adam Smith’s bakers and candle makers: division of labor and innovation depend on reciprocity, and specialization imposes mutual dependence. As David Hume wrote, “I shall therefore venture to acknowledge, that, not only as a man, but as a British subject, I pray for the flourishing commerce of Germany, Spain, Italy, and even France itself” (Lippmann 1943 [1937], 194). One of the important aspects of the New Deal “concert” was that the orchestra was composed of foreign as well as domestic players, and while they could not be expected to buy up agricultural surpluses if they could not sell their manufactures in

competition with US producers, if all were expanding then all could sell more agricultural goods and manufactures. Clearly, national self-sufficiency is a policy for a war economy, which is a planned economy. Trade restrictions as an attempt to steal purchasing power from foreigners are just as much an imposition on individual liberty as any other type of regulation.

The divisions and disputes with which we contend today, and which have contributed so much to the current slow recovery, find their source in the failure to recognize Lippmann's "obvious error": that is, the blind belief that reducing regulation, the role of government, and the size of the administrative state will somehow restore a laissez-faire market liberalism that never existed and is inappropriate to the changing structure of production of both the US and the global economy. This reflects Keynes's conclusion in his *General Theory*: "The outstanding faults of the economic society in which we live are its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and incomes" (Keynes 1936, 372). These are the areas in which government action is not only appropriate, but also necessary, because the tacit assumptions of classical analysis are, in Keynes's words, "seldom or never satisfied, with the result that it cannot solve the economic problems of the actual world" (378). However, he added,

if we suppose the volume of output to be given, i.e. to be determined by forces outside the classical scheme of thought, then there is no objection to be raised against the classical analysis of the manner in which private self-interest will determine what in particular is produced, in what proportions the factors of production will be combined to produce it, and how the value of the final product will be distributed between them. (378–9)

It is here that Keynes joins the New Deal "concert" in recommending that "the State will have to exercise a guiding influence," in coordinating consumption and investment to ensure sufficient demand to exploit the full productive potential of the economy (378).

It is interesting that the problems faced by the new administration are so similar to those of the 1930s: income inequality, lack of sufficient fiscal support for employment, and the management of external trade and payments. Those who follow the Levy Institute's publications will note the similarity between

this characterization of the problems facing recovery from the Depression and those identified in recent issues of our Strategic Analysis (Nikiforos and Zezza 2017; Papadimitriou, Nikiforos, and Zezza 2016). While it would not be appropriate to recommend New Deal policies in the current economic environment, it would be appropriate to note that the current battle cry of reducing regulation and the size of government risks repeating Lippmann's "obvious error" by refusing to recognize the government's responsibility in dealing with the failure of social conditions to adapt to changing productive structures. In this regard, one cannot resist the opportunity to mention Hyman Minsky's proposal for an employer-of-last-resort program—which would provide a remedy for both the problems of unemployment and the government's flagging fiscal support—as a more modern substitute for the New Deal employment-creating measures (Levy Institute 2009).

There is one final area of similarity with the experience of the New Deal that it is important to raise. Minsky was the architect and inspiration of the Levy Institute's annual conference series. In his planning notes for the first conference, which was held in November 1991 under the title "Restructuring the Financial Structure for Economic Growth," Minsky emphasized the importance of structural reform of the financial system as the prerequisite for more sustainable growth and employment (Minsky 1991). That conference took place in the aftermath of a major real estate crisis that produced considerable changes in the institutional structure of the financial system—some through the purging of unsustainable institutions, and others through regulatory and legislative responses. Minsky's idea was to bring together academic economists and professionals and officials facing issues in private finance or in regulatory public policy to discuss a new institutional framework. At that time the discussion was centered on the attributes of universal banks relative to bank holding companies, and whether it would be appropriate to allow nonfinancial corporations ownership of financial institutions.

Minsky was not attracted to the universal banking model. He instead opted for an adaptation of the holding company model in which each subsidiary dealing with a particular banking function would be separately capitalized from the holding company itself (see Kregel 2012a). This approach has more recently been under discussion in the form of what the Vickers report called "ring-fencing" (Independent Commission on Banking 2011). Vice Chairman of the Federal Deposit

Insurance Corporation Thomas Hoenig's recent proposal (Hoenig 2017) reflects some of these ideas, but limits the capitalization of the regulated banking subsidiary.

In order to deal with the problem of deposit insurance, Minsky's discussion went beyond barriers, suggesting that while insurance might be maintained, it would be most appropriately applied to the subsidiary financing business loans than to the liabilities of the ring-fenced subsidiary offering payment services (Minsky 1995). He also was in favor of the introduction of community banks and organized a Levy Institute project in that direction (Minsky et al. 1993). Esther George, president of the Federal Reserve Bank of Kansas City, has taken a special interest in this topic (George 2017).

By the end of the 1990s, Minsky was no longer present, but the debate on the economy's financial structure was again at center stage due to the continuing crisis in mortgage financing created by the disappearance of traditional savings and loan banks and the continuous blurring of the 1933 Glass-Steagall Act's lines of division between what were commercial banks, in name only, and investment banks, which had encroached on the retail payments system. Banks took on universal functions within a financial holding company structure, but absent the separate capitalization Minsky had proposed earlier. We all know the result of this silo-type structure, in which it became increasingly difficult for managers and regulators to understand the overall risk exposure or what resources were available for meeting potential losses.

The regulatory response to the failure of this structure has been a push for higher and higher regulatory capital in the hope that there will be enough to cover the ever-higher losses the system is assumed to be destined to generate. In addition, regulators have imposed liquidity requirements in the form of asset characteristics. But as Minsky, following Keynes, had pointed out long ago, there is no characteristic of assets called liquidity; the ultimate source of liquidity is the ability to convert an asset into means of payment, and this depends on the issuer's access to the regulated banking system and the banks' access to the Fed discount window. Unfortunately, in an attempt to shield taxpayers from loss and constrain Fed independence to act in a crisis, the 2010 Dodd-Frank Act has sought to limit this crucial aspect of systemic liquidity that has resided in Section 13(3) of the Federal Reserve Act.

The most important point is that despite Dodd-Frank, the overall financial structure has remained unchanged. Minsky

would have considered this a mistake, noting that the push for higher capital ratios would eventually lead to the equivalent of 100 percent banking, which would neuter the ability of the financial system to create the liquidity that allows it to undertake the risky financing required to fund the productive capital structure of the system (Kregel 2012b).

Minsky would also have noted that the liquidity of assets is determined by the willingness and ability of regulated banks to take them on their balance sheets in exchange for more liquid liabilities—100 percent banks cannot do this, whether the ratio is applied on the asset or the liability side of the balance sheet. It is interesting that we are now starting to see criticisms, such as in the recent farewell speech of Daniel Tarullo (2017), to the effect that aspects of the Volcker rule are reducing the liquidity of financial markets. Given that dealer spreads and minimum size are a function of dealer capital, this should not be surprising. Higher capital requirements and higher liquidity requirements are, in essence, mutually contradictory.

So we are back to the initial question that Minsky faced—how to change the institutional structure—and a decision between Representative Jeb Hensarling's Financial Choice Act and its emphasis on capital requirements, Senator Elizabeth Warren's return to a 21st century Glass-Steagall, and Thomas Hoenig's proposal to refine the holding company structure. The first two proposals are already tabled in the House, and although the Trump campaign expressed some interest in a return to Glass-Steagall principles, it is not clear what path the administration will take. However, early indications suggest the Trump administration is falling into Lippmann's "obvious error" in the financial regulatory arena as well. Even if it does not adopt the particulars of New Deal policy, the administration would do well to embrace the broader lesson of the 1930s: that government regulation and fiscal policy are crucial in addressing changes in the economic and financial structure that have exacerbated the problems faced by struggling communities—communities that are in danger of being "forgotten" once more.

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