

The Return of Big Government: Toward A Minskian New Deal

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Finance Capitalism

- The second collapse of Finance Capitalism
 - Complex, long-lived capital assets
 - Requires external finance, prior commitments of earnings
- First version: small govt, laissez faire; failed
- New Deal → big govt, paternalistic state
 - High W, High C, Unions, Welfare
 - Growth leveraged Treasuries from WWII
 - Big Govt: multiplier, cash flow, portfolio effects
- Finance Capital returned in the form of Money manager capitalism: Big Govt, Predator State

Boom and Bust

- 1980s Savings and Loan Crisis
 - Commercial real estate
 - Developing country crises
- 1980s Leveraged Buy-outs
 - Michael Milken and Junk Bonds
- 1990s New Economy and Nasdaq
 - “Irrational Exuberance”
- 2000s Residential Real Estate
 - Subprimes; foreclosures
- 2000s Commodity Markets
 - Quadrupled oil prices; food riots; starvation

Each crisis worse than the previous

Managed Money and the Systemic Nature of the Crisis

- *Irrational exuberance; Minsky Moment?*
No—seeds of crisis sown long ago.
 - By Fed’s increasingly aggressive use of rate changes to fine-tune economy
 - By financial institution innovations to make credit more elastic
 - By deregulation and gradual removal of New Deal constraints
 - By growth of managed money with appetite for risk



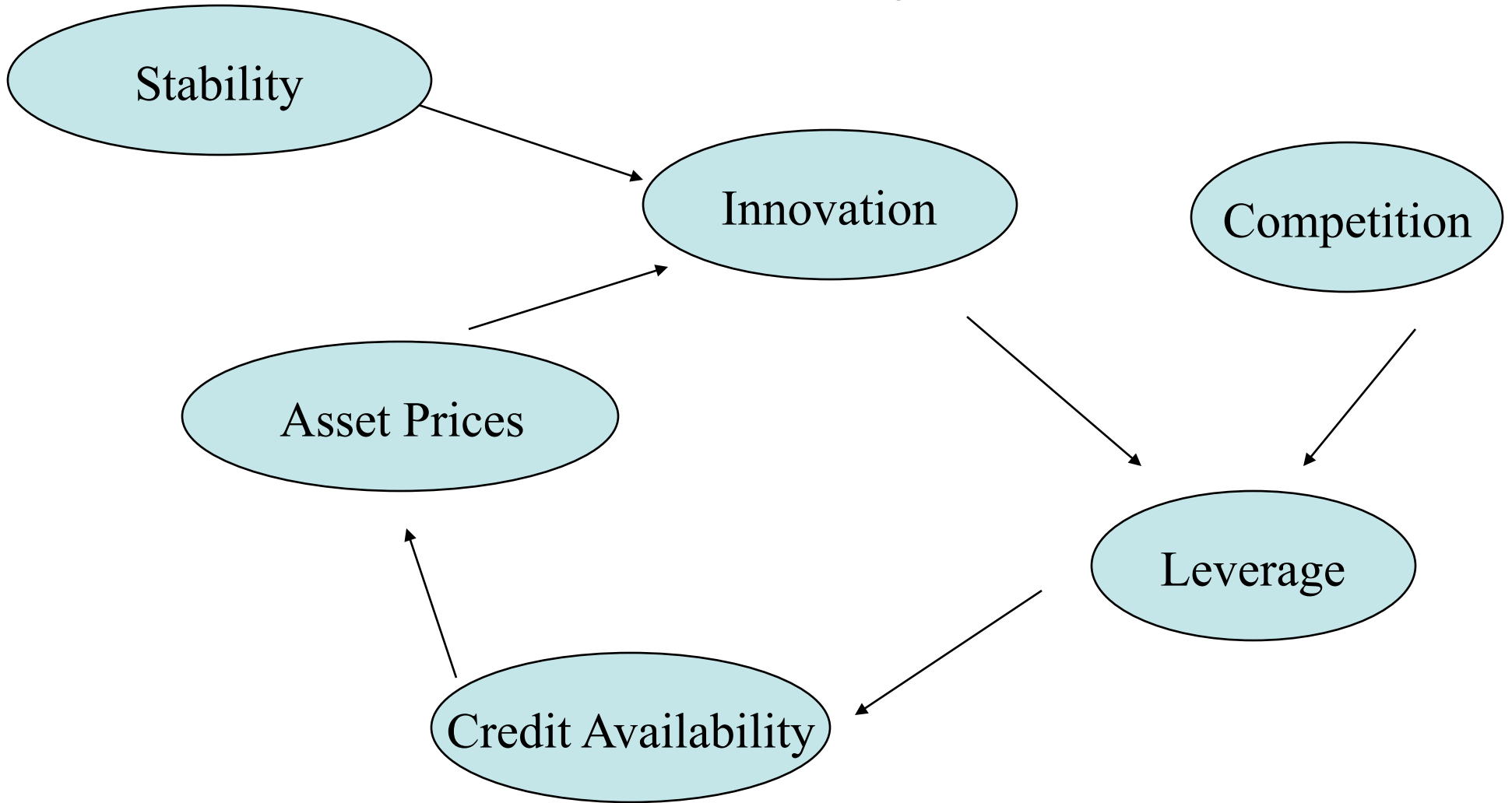
I'M AFRAID
OUR EXPERIMENTS
HAVE CREATED
A BLACK HOLE

CHAPATTE

Stability is Destabilizing

- If risky innovations had led to losses, they wouldn't have been retained
- But Big Bank and Big Gov't constrained instability; allowed fragility to increase
- And allowed managed money to grow
- Shifted weight of financial system away from regulated/protected banks to pension funds, mutual funds, hedge funds, sovereign wealth funds, university endowments: **Managed Money**
- Leveraged housing and commodities not Treasuries
- Evolved to much riskier financial system:
Hedge → Speculative → Ponzi

Virtuous Cycle





LEHMAN BROTHERS

SUBPRIMES

M. R. P. '08

Obama's Recovery Plan

- Public Infrastructure; up to 3 million jobs
- Create 5 million “green jobs”
- Address inequality: strengthen unions, raise min wage, reduce taxes for middle-class
- Subsidize states' share of Medicaid and child health
- All of these good ideas endangered by Timmy and Larry Side Show:
 - TARPS, PPIPS, Fed purchases of toxic waste, and other bailouts: life insurance, auto manufacturers, credit cards issuers, LBOs
 - Beyond bailouts: recruiting “mainstreet” to buy junk assets w/leverage
 - Reproducing conditions of 2006: high leverage, stated values, opaque deals, wrong incentive structure

Paulson/Geithner Plans: **Trying to restore Money Manager Capitalism**



Congressional Oversight Panel: All successful crisis resolutions required:

- **Transparency.** Swift action to ensure the integrity of bank accounting, to ascertain the value of bank assets and hence assess bank solvency
- **Assertiveness.** Willingness to (1) take early aggressive action to improve capital ratios of banks that can be rescued, and (2) shut down banks that are irreparably insolvent.
- **Accountability.** Willingness to hold management accountable by replacing – and, in cases of criminal conduct, prosecuting – failed managers.
- **Clarity.** Transparency in the government response with reporting of all forms of assistance being provided and clearly explained criteria for the use of public sector funds.

4 strikes and you're out?



Short run crisis package I

- Liquidity: Urgent; Lend w/o limit or collateral to all; expand FDIC
- Paulson/Geithner Plans: who needs socialism when Goldman runs Treasury? Discard and reverse where possible
- Insolvency: No urgency; Now need receivership, replace and constrain mngmt; Adopt too big to save doctrine
- Stimulus: need tax relief *and* govt spending:
 - Unemp comp, infrastructure, \$400B block grants
 - Payroll tax holiday: \$4025 saving for average worker and same for her firm

Short run crisis package II

- Fiscal stimulus: need tax relief *and* govt spending: unemp comp, infrastructure, \$400B block grants
- Mortgage relief: refinance on favorable terms; rent to own; combo of private and socialized losses; bigger role for renationalized Fannie and Freddie
- Get on right side of 30-1 leverage
- Jail the crooks: vastly increase budgets, hire criminologists, pursue up the entire real estate food chain: originators, appraisers, accountants, risk raters, and Wall St money mngrs



A Minskian New Deal, Part I

- Payroll tax reform: regressive, inflationary, discourages employment. Abolish Trust Fund; paygo and tax all income to share *real* burden
- State and local govt: reverse devolution; eliminate regressive taxes, Fedgovt replace lost revenue \$for\$
- Inequality: unions, min wage, good jobs
- Reform retirement: more generous public system; less subsidy to money mngrs
- Health care: nationalized, rationalized

A Minskian New Deal, Part II

- Infrastructure and social spending: govt ratchet, permanent to enhance stability
- Financial reform: Listen to mkt: we don't need NINJAs or rocket scientists or Chinese finance of US homeownership.
- Govt of, by, and for Goldman is no way to run a country; Euthanize Wall St.: drive stake through heart of M-Mngr capitalism
- Job guarantee: human rights, equity, efficiency, and stability all require jobs:
12-20 Million permanent jobs

Return of Fiscal Policy

- Affordability: gov't can afford to buy anything for sale in domestic currency
- Can always achieve full emp
- Can enhance price stability
- Can enhance economic stability (income, output)
- Can enhance financial stability
- How: Minsky's ELR program

Minsky: Policy to promote stability

- High consumption, high employment
- Greater equality, rely on income, not debt
- Favor small to medium size banks; CDBs, not predatory lending
- Enhanced oversight; strengthened regulation
 - Nothing off-balance sheet
- Stable interest rates
- Institutions and practices to favor stability
 - Regulation by function
 - Circuit breakers
 - No private protected institution should be “too big to fail”
- No “final” solution to fundamental flaw of capitalism

Conclusion: What we learned from Minsky

- Great Depression = failure of small govt, laissez faire economy
- New Deal promoted highly successful Big Govt/Big Bank model
- Stability bred instability, promoted by deregulation and successful innovations
- Current crisis decisively repudiates Big Govt/NeoCon model that favors self-supervised mkts and socialized risk

For Further Reading at
www.levy.org

- ***Financial Markets Meltdown: What can we learn from Minsky?***
- ***What's a Central Bank to Do? Policy Response to the Current Crisis***
- ***The Commodities Market Bubble: Money Manager Capitalism And The Financialization Of Commodities***
- ***The Return of Big Government: Policy Advice for President Obama***