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Finance and Stability: The Limits of Capitalism

by
Hyman P. Minsky*

Working Paper No. 93

May 1993

*Distinguished Scholar, The Jerome Levy Economics Institute of Bard College

Presented at a Conference on "The Structure of Capitalism and the Firm in Contemporary Society", Milan, Italy, March 18-20, 1993.

I participated in a Conference on Financing Prosperity in the 21st Century at the Jerome Levy Economics Institute of Bard College on March 4, 5, and 6 1993. March 4 was the 60th anniversary of the inauguration of Franklin D. Roosevelt as President of the United States and March 6 was the 60th anniversary of the bank holiday in the United States.

The problems Roosevelt faced sixty years ago and the problems confronting President Clinton resonate. Roosevelt inherited a failed capitalism and a new model capitalism was put in place during his first term (1933-1937). Roosevelt's new model served the United States, and the world, well for almost half a century.

Over the past dozen or so years the 1933-1937 model has shown its age. Although it has not broken down as completely as the older laissez-faire model had over the 1929-33 period, quite clearly our current model of capitalism needs to be at least thoroughly overhauled if not replaced. Whether he realizes it or not, the historic task of President Clinton is to discover and put in place a new model capitalism.

The usual description of the 1933 bank holiday is "Roosevelt closed the banks." This is not true. By March 4th 1933 the banks in some 30 states had been closed by the Governors of the states. On Saturday March 4, as Roosevelt was being inaugurated he was informed that the New York

banks would not open on Monday March 6. The bank holiday was a preemptive strike - it was forced upon Roosevelt. This act moved the solution of the problem of illiquid and insolvent banks and other financial institutions from the Financial Community to the Federal Government.[1]

The bank holiday was the climactic event of a great contraction of the American economy that began in October 1929 and lasted until March 1933 - more than 40 months of monotonic decline. The decline was not only long, it was also deep. Output fell by about 33%, prices fell by about 33%, and the indices of stock prices (The Dow Jones or the Standard and Poors) fell by some 85%. In the winter of 1932/33 unemployment was at least 25% of the labor force; this in a country where 1/3 of the labor force was in agriculture.

Sixty years ago capitalism was a failed economic order in the United States and throughout the world.[2] Today as the call for this conference notes "the whole world is capitalist". We have to address the following questions

1). "What flaws made capitalism a failure in 1933?",

2) "What turned a failed system into a success?" and

3) "Were the capitalism that failed and the capitalism that succeeded the same economic order?".

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1. In the crisis of 1907 the House of Morgan played a central part in resolving the crisis. In the crisis of 1933 the government through the Reconstruction Finance Corporation played the central part in resolving the crisis.

2. We should recall that Hitler became Chancellor on January 20th. Although Roosevelt was elected in November of 1932 Hoover remained President until Noon on March 4, 1933.

Even as we celebrate the "victory" of capitalism we are aware of the current problems and crises of the once very successful post war capitalisms. While the capitalisms of the United States and Western Europe were truly successful societies during the first two and a half decades after the second world war, their performance over the last decade and a half falls short of the standard achieved earlier. Japan, which seemed to have escaped many of the problems besetting the United States and Western Europe in the past decade, now seems to be catching up. We add two questions to our list:

4) "What attenuated the success of the early post war capitalism?"

5) "Why are the welfare states of the post war world now in crisis?"

One reason capitalism won and the Soviet version of socialism lost was that the Lenin-Stalin version of socialism allowed for only one form, the highly centralized linear command model, whereas, as the call for this conference recognizes, capitalism comes in many forms.[3] The successful capitalisms of the 1950's through the 1970's were not the same as the capitalisms that failed in the 1930's. In general a system which we can characterize as a small government gold standard constrained laissez-faire capitalism was replaced by a big government flexible central

3. At one time the slogan of the Heinz pickle and ketchup company was "57 Varieties". When I make the point about the varieties of capitalism In America, I often say that "There are as many varieties of Capitalism as Heinz has of pickles."

bank interventionist capitalism. As Kalecki and Jerome Levy pointed out, a government deficit is the equivalent of investment as far as the maintaining of the profits of enterprise is concerned. The big government capitalism put in place in the 1930's and after World War II were and still are protected from a severe fall in aggregate profits, such as occurred in the great contraction of 1929-33.

Most acutely the crisis that confronted Roosevelt consisted of the high unemployment rates, bankrupt businesses and farms, and the virtual destruction of the financial system. Until the discovery of the power of government contracts for defense production to spur civilian employment the Roosevelt government resorted to a variety of inadequately funded government employment devices to offset the weakness of the private demand for labor.

The reconstitution of the financial structure was a major task and it involved a great deal of thought and negotiation. It was not until 1936 that the new financial structure was in place. The 1936 financial structure of the United States was based upon two principles, compartmentalization and transparency. The financial structure was reconstituted with special financial organizations for delineated functions i.e. housing, agriculture, imports and exports, commercial banking, investment banking and deposit insurance. A government investment bank, the Reconstruction Finance Corporation, infused government equity into transportation, industry and

finance.[4] The operations of the publicly traded corporations and the markets in which the trading took place were to be transparent. In addition the Federal Reserve was reorganized in quite fundamental ways.

The financial institutions of the post 1936 era differed markedly from that which broke down between 1929 and 1933. This system once in place began to evolve in response to the profit seeking efforts of the various institutions: any institutional structure which sets limits to the behavior of economic units will set off actions designed to evade or avoid the limits. Furthermore technological changes will impinge upon units in the financial structure in quite varied ways. As a result even though the Roosevelt structure remained in place, the details of financial operations and institutions changed. In particular households, firms, government units as well as financial institutions learned how the system worked and adapted their behavior to best exploit the changing financial environment. These changes led the greater use of debt relative to internal finance as well as the use of debt to acquire existing assets. As a result the once robust financial system became increasingly fragile. As fragility

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4. The public infusion of equity took the form of the RFC acquiring a special issue of preferred stock. The RFC did not hesitate to exercise its power by replacing managements that were deemed to be weak. As recovery took place and the banks, railroads and ordinary businesses that had been refinanced by the RFC made profits they purchased or retired the preferred stock issues. See Jessie Jones "50 Billion Dollars"

implies that there may be large responses to small stimuli, a fragile structure is an unstable structure.

Whereas there was no threat of a financial crisis between the end of World War II and 1968, the repercussions of the commercial paper market to the default of the Penn Central Railroad on its commercial paper rudely awakened the rather complacent Federal Reserve Board of Governors that it has responsibilities for maintaining the stability of the financial system. Since 1968 the Federal Reserve has often been forced to take steps to abort what it deems to be an embryonic financial crisis.

The capitalisms that failed and the capitalisms that succeeded were different in details that are significant for their performance. The big government capitalisms of the 1950's and 60's succeeded in moderating business cycles because the big governments were able to sustain business profits when investment lagged. One significant result of profits being sustained was that the absence of long recessions strengthened trade unions. The combination of strong trade unions, a lack of severe labor redundancy and the social legislation that marked this era led to the lot of those at the "bottom" of the income distribution improving.

President Kennedy caught the flavor of the experience of these years in an aphorism "A rising tide lifts all boats." This aphorism was validated by the experience of the 1950's and 60's, just as it was negated by the

experience of 1980's, when the lot of those at the bottom either deteriorated or stagnated even though aggregate income presumably rose. It seems clear that capitalisms can function in different ways and that preference systems and the technical conditions of production do not lead to a "law of distribution."

If capitalisms are to be successful in the 21st century they are likely to be quite different from the models we are familiar with. Now that Roosevelt's new model of capitalism has shown that Kennedy's aphorism can be true, the ends that a successful economy needs to achieve includes a wide distribution of the fruits of prosperity than was achieved over extended periods of time by the old model capitalism. Reagan and Thatcher tried to overthrow the big government interventionist capitalisms that they inherited. In the United States the major substantive changes in the economy of the Reagan years were 1) the destruction of the revenue system, 2) the emergence of an economy that was structurally dependent upon the government's deficit financing of a budget that was mainly devoted to military spending and to supporting consumption, 3) the fall in the real wage of a large portion of the labor force and 4) a rising tide of un and under employment.

After a spurious prosperity, largely based upon 1) an unproductive government deficit, 2) an enormous expansion of the financial services industry and 3) Ponzi financing schemes that left the country with an excess supply of

office structures and highly indebted firms, the Reagan-Bush years saw the economy of the United States stagnate. Furthermore government spending was even more inefficient in the use of government to create resources than before Reagan and Bush took office because the great expansion of the government deficit left the budget with a huge item "interest on the debt".

The Reagan-Bush experience is a second failure of the laissez-faire model. It showed that the laissez-faire model cannot meet the standards established in the 1950's and 1960's, the era when capitalism achieved a practical best. Clinton in his still new administration is groping towards the invention of a "new" new capitalism. This new model accepts the central tenet of Rooseveltian capitalism, which is that effective capitalism requires a large government sector, but it shifts government spending from financing defense and consumption to financing resource creation and the efficient delivery of services for which the fee for services mechanisms for the recovery of costs are not effective. This leads to another question:

6). "Can we discern the general outlines of a new capitalism that may emerge in the United States?"

I have raised six rather overlapping questions. I have addressed some in my exposition of the problems. I have not addressed the questions of what are the flaws that made capitalism a failure in 1933 and whether these flaws are the result of attributes of capitalism which are essential

characteristics of capitalism. I will also address the question of what turned the failed system into at least a transitory success.

One striking flaw of capitalism - which was identified by Marx and Keynes - is its inability to maintain a close approximation to full employment over extended periods of time. Keynes recognized that capitalism is not merely a market economy: it is also a financial system. A fundamental aspect of the capitalism of Keynes' time and ours is that there are *two* sets of prices. One set consists of the prices of current output and the other set consists of the prices of assets, both the capital assets used by firms in production and the financial instruments that firms issue in order to gain control of the fixed and working capital they need.[5] The price of current output carries profits and is the mechanism by which costs are recovered. In the abstract these prices are keyed to the money wage rate. The price of capital assets and financial instruments are present prices for future streams of incomes. As these two sets of prices reflect what happens in two different sets of markets they will vary independently.

The financial instruments issued by firms are held by households and financial institutions such as banks.[6] Ever

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5. See Hyman P. Minsky, John Maynard Keynes, Columbia University Press, 1975 and Stabilizing an Unstable Economy, Yale University Press 1986.
6. In a modern economy household and government debts exist and are held by financial institutions and directly by households. These other liabilities complicate the cash flows and offer routes which can dampen and amplify the

since the corporation became the dominant form of business organization, the liabilities of firm's include equity shares as well as various forms of debts. The equity shares and some of the debts of some companies are freely traded on public markets: the market value of these instruments depends upon publicly available information. In principle the second price level of capitalist economies is an index of the market price of existing capital assets but in practice it is an index of the market price of shares and debts. The growth of the holding company form of corporate capitalism means that entire lines of business are sold and bought. The model of the second price level needs to incorporate how such components are valued.

The reforms of the financial system during the Roosevelt era made transparency the over riding principle, guiding the information available about the operations of corporations and of markets on which equity shares are traded. Other debts of corporations do not depend upon publicly available information but rather on negotiation and discovery: these are debts to banks and private placements to other financial institutions. Such debts, which are not marketable can be syndicated among institutions, such as banks, which are knowledgeable about processing private information.

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effect of the debt structure on the performance of the economy.

As a result of the security market reforms of the Roosevelt era the law caught up with the fact that modern capitalism is corporate capitalism.

Over the more than 40 months of the great contraction the price level of current output fell by 33% whereas the price level of equities on the stock exchanges fell by 85%. In 1933 it would cost 67% of the 1929 price to produce investment output but it would only cost 15% of the 1929 price to purchase a firm on the stock exchange. Similar ratios held for commercial buildings such as office towers. If the ratio of the prices of old and new capital assets was greater than 1 to 1 before 1929, in 1933 the ratio of old to new was 1 to 4. In 1933 no one would order new investment output when the second hand market for investment, the market for capital assets, was full of bargains.

In standard economic theory prices are the terms upon which alternative goods and services are available. As the theory is set up all that really matters are relative prices. However to producers in a capitalist economy output prices recapture wage and material costs and carry profits. Profits enable a firm to pay the interest and principle that is due on debts, and to provide funds for dividends and retained earnings. Inasmuch as debts are almost always denominated in money, to producers nominal prices matter. In the markets where assets, financial and real, are traded the prices are the present money price of future money

flows. The market value of a firm is a capitalization of its nominal profits and therefor is stated in nominal terms. In a progressive capitalist economy investment outputs are a part of current output. When investment outputs are completed they are assimilated to the stock of capital assets: the investing firm pays the investment producer for the investment good. This payment is made with internal funds (retained earnings), funds raised by the sale of equities and funds raised by debts, either as borrowings from banks or as the receipts from the sale of bonds. At the moment of purchase the value of a particular investment output changes from being determined by the sales price to being determined by the present value of the future incomes that operating and otherwise using this asset is expected to generate.[7]

No one would use current resources to produce items for the stock of capital assets if *the present value of capital assets*, as determined by markets which transform expected future profits of firms into the market value of debt and equity liabilities of firms, is not equal to or greater than *the price* the producers of the investment good need to charge in order to recover the costs of producing the investment good and to earn the profits that enable the investment goods producers to be viable firms.

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7. There is a normal capital gain in the shift of the valuation of assets from the price of the investment goods to the present value of future earnings.

In a modern rich capitalist economy corporations are the proximate owners and the actual operators of the non-housing, non-agricultural capital stock of the economy and the principal purchasers of investment output: corporations are also the principal proximate recipients of capital income or gross profits.

A capitalist economy can be viewed as a set of interrelated balance sheets and income statements. There are two ultimates in this formalization: firms, which own the capital stock of the economy, and households, which own the financial liabilities of other units as assets. Financial institutions stand between firms and households. Today to a large extent the liabilities (equities and debts) of firms are owned by financial intermediaries of one type or another and the assets of households are largely liabilities of financial intermediaries.

These intermediaries - banks, savings institutions, insurance companies, mutual funds and pension funds to identify the most prominent financial intermediaries - are self, or profit, seeking institutions. In a modern capitalist economy maximizing behavior is not restricted to households and firms that own capital assets, for the entire array of financial intermediaries seeks profits. Each profit seeking financial intermediary has an agenda of its own: they are not charitable institutions.

Of these profit seeking private agenda financial organizations one set plays an exceptionally delicate role

in capitalist economies. This set consists of the investment or merchant bankers who either as brokers - who bring buyers and sellers together - or dealers - who take financial liabilities into their own accounts - act as *midwives* to the start up of companies and the financing of continuing operations.

Essentially these operators have superior knowledge about their customers who need financing (they have a need for funds) and their customers who have a need for outlets in which money can be placed. They turn this private knowledge of the conditions under which funds are desired and the conditions under which funds are available to their own advantage, even as they perform the social function of selecting the investments that the economy makes.

These financial intermediaries are of critical importance in determining the values attached to capital assets as collected in firms. In a balance sheet the difference between the sum of the values entered for capital and financial assets and the value of debts on the liability side is the book value of the owners interest in the firm. Dividing the book value of the owners equity by the number of outstanding shares yields the book value of a share. However for the main companies in a large economy there is a thick market for equity shares and this market value may be less than, equal to or greater than book value. A main consideration in decisions to invest is that the market valuation of the capital assets needs to exceed the supply

price of the investment output, with a margin of safety that allows for the riskiness of the project.

One consequence of the introduction of these layers of profit seeking organizations in the markets which determine the value of financial instruments is that the value of financial instruments and therefor the value imputed to capital assets can and does vary independently of the cost of investment outputs. Furthermore the extent to which internal funds are available to finance investment depends upon the excess of anticipated cash flows from operations over the amount needed to service liabilities that were issued to finance such acquisitions in the past.

Because the capitalization rate depends upon present views of the future and the value of the secure assets in portfolios, the ratio of market price of capital in firms to the market price of investment outputs can vary. The very structuring of the argument in terms of a demand for investment output that depends upon the capitalizing of future profits and the determination of the supply price of outputs as dependent upon labor costs of producing these outputs assures that the supply and the demand relations would not, in economist jargon, be homogeneous of degree zero in either money or in money wages. The result would also not be independent of the extent to which positions of market power are capitalized into the price level of capital assets.

Thus 1) the capitalist technique of valuing outputs and valuing capital assets, 2) the market determination of liability structures and 3) the possibility of sharp increases and decreases in the market price of capital assets and financial instruments leads to systematic increases and decreases in the price of assets relative to the price level of current output. This feeds into the amount of investment financed, which in turn leads to the flow of current profits.[8]

Once current profits fall by enough, or the carrying costs of debts increases by enough, so that the cash flows earned by operations or from financial assets by highly indebted operations are insufficient to meet commitments on liabilities then the pressure of the need to validate debts (and to meet withdrawals by depository institutions) leads to a proliferation of attempts to make positions by selling out positions. The result can be a sharp fall in asset values. A downward spiral is a possibility in which investment ceases and profits evaporate: the end result of over indebtedness can be a great or a serious depression. Although the obvious flaw in capitalism centers around its inability to maintain a close approximation to full employment, its deeper flaw centers around the way the

8. The relation between the price level of capital assets and current output along with other factors determines the volume of aggregate demand and the excess or deficient demand for labor at the current wage rate. The excess or deficient demand will affect the movement of wages and thus the price level of investment output.

financial system affects the prices and demands of outputs and assets, so that from time to time debts and debt servicing rise relative to incomes so that conditions conducive to financial crises are endogenously generated. Such a crisis, if not contained by a combination of Central Bank lender of last resort interventions, which sustain asset prices, and government deficits, which sustain profits, leads first to a collapse of investment and then to a long lasting depression accompanied by mass unemployment.[9] This financial flaw cannot be eradicated from the corporate form of market capitalism, in which liabilities exist that are prior commitments of the gross nominal profit flows of corporations. Reforms which constrain the possibility of using excessive debts for specified purposes were part of the new model capitalism of the 1930's. Many aspects of these constraints were relaxed by the 1980's, especially critical constraints upon the assets eligible for the portfolios of the Savings and Loan Associations were relaxed. The result was a series of crises of financial institutions and corporate indebtedness. A big depression did not happen in the early 1990's because the government validated the debts of the financial institutions that became insolvent and the huge government deficits sustained profits.[10]

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9. In this view the intervention by a deposit insurance authority to assure that deposits at "protected institutions" are paid at par is a central banking action.
10. This validation has been called a bail out.

The new model capitalism that emerged out of the great depression and the second world war had much larger government sectors than the failed model of the 1920's. Central banks were no longer constrained by the gold standard: they were now expected to use their ability to affect the behavior of banks to sustain income and employment and contain any thrust to an accelerating inflation or a deep deflation. The ability of a country to float its currency was much greater and the responsibility for maintaining aggregate demand by government and even by international cooperation was acknowledged.

For much of the period in which the new interventionist model worked well the sole governor of the international system was the United States' commitment to maintain its domestic economy at a relatively close approximation to full employment and willingness of the United States to run a trade deficit.

Capitalism failed in 1929 because of the flaw inherent in the two price system nature of capitalism. Capitalism was reconstructed in the 1930's and after World War II with a much greater government sector, which in the United States was largely devoted to sustaining consumption and military spending. Nevertheless private investment remained the major determinant of the increase in productive capacity and the value of private investment still rested upon the price level of capital assets being greater than the supply price of investment outputs. The flaw that over indebtedness can

lead to a sharp decline in the ability to validate debts and therefor to a sharp fall in the value of capital assets as collected in firms remained.

The recent history of the United States is a history of a thrust towards a debt deflation that was contained by a combination of central bank intervention and massive government deficits. The contained depression of the early 1990's ultimately led to a sharp fall in first short term interest rates that, with a lag, is being followed by a fall in longer term interest rates.[11] This fall in interest rates led to a rise in the present values of income streams: Asset values increased and as a result the turbulence in financial markets in the United States has abated.

The capitalism that failed over 1929-33 was a small government constrained Central Bank essentially laissez-faire economy. The capitalism that had a good run after the second world war was a big government interventionist economy with central banks that were less constrained than during the inter war years.

The post World War II model of capitalism was so successful over the first twenty plus years after the War that some are given to calling that period a Golden Age. While in truth it was not a utopian Golden Age, each of us can find fault with some details of the economy of the

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11. S Jay and David Levy "How to Restore Long-Term Prosperity in the United States and Overcome the Contained Depression of the 1990's", The Jerome Levy Economics Institute, Annandale-on-Hudson, New York 12504

1950's and 1960's, it might very well be <u>a practical best</u>. On an absolute scale the most recent twenty plus years after World War II were not bad, but they suffer by comparison. However a clear path of deterioration is discernible over these years, in part because of policies such as those which Reagan and Thatcher exemplify, in part because of the way in which protracted success leads to an acceptance of commitments to pay which erode the margins of safety which make capitalist firms and financial institutions resilient. The junk bond episodes and the commercial construction excesses are built into the way in which business men and bankers interact in a capitalist economy. Only capitalist economies in which the regulatory agencies have stronger and more sophisticated controls than the regulatory agencies have in the United States can avoid the financial excesses that bring financially complex economies to the brink of collapse.

"Why are the welfare states of post World War II capitalist economies now in crisis? " is the fifth question. I can answer for the United States. The Social Security system, which is the keystone of the welfare state in the United States, was never adjusted for the enormous increase in life expectancy over the past sixty years. If the life expectancies now were as they were 60 years ago there would be no crisis in the social security part of the United States' welfare state. The solution to this is rather simple: increase the age at which people retire. However

this would increase the labor force. Therefor there is a need to increase the number of available jobs.

Another problem of the welfare state in the United States is with what is called welfare in the United States. This system, Aid to Families with Dependent Children (AFDC), provides cash and in kind (medical care, housing and food subsidies) support to families with children, if income from work or assets is not able to support the children. In practice a significant part of the population that is welfare dependent is seemingly locked into a pattern of dependency: women who themselves were illegitimate and recipients of AFDC having children on AFDC. This welfare problem is increasingly viewed as a disaster in terms of the well being of the recipients. However the alternative to welfare is work for the mother and child care for the children.

Welfare reform leads to a similar problem as social security reform. Having people now on welfare or on Social Security enter the labor force increases the demand for jobs. The problems of the welfare state in the United States stem from the inability to achieve and sustain a tight full employment without triggering inflation.
We now live in a world where less than 3% of the United States' labor force is in agriculture and where an ever decreasing percentage of workers can produce all of the standard manufactured goods that the economy demands. There is a need to support more workers in the production of

socially useful outputs that are not manufactured goods and where the costs may not be recoverable by any fee for services arrangement. In the United States military spending on both weapons and manpower supported workers whose costs were not covered by a fee for services arrangement: taxes and government indebting raised the funds for such expenditures. There is a need to replace the military use of available resources with other forms of use which do not depend upon fees for services for funding. There is one crisis in America's welfare state which is different in kind than those in Europe. During World War II the United States began job related health care "insurance" and job related supplements to Social Security in the form of pensions that were liabilities of corporations. Corporations also took responsibilities for the health care of their retired workers. These pensions were not funded until the 1970's and even now many are only partially funded. These pensions typically are vested after quite a few years on the job and until recently were not portable. Over the past several years a large number of the greatest corporations of the United States have had serious financial difficulties. Some have gone through bankruptcy and others have downsized dramatically. Firms have taken drastic steps to reduce not only their shop floor workers but also their overheads. The security of employment in the United States was never as great as in the Japanese system, but it certainly was much greater in the past than it is today.

The newly revealed vulnerability of corporations means that the private pension and health care systems of the post war period are no longer viable. The Clinton administration is attacking the problems of our health care system. As yet there is no serious attack on the problems of the pension system that supplements Social Security.

The Clinton administration is a repudiation of the economics and the social policies of the Reagan-Bush years. It accepts that there are government functions which are legacies of the past which need to be cut if not eliminated. There is also a recognition that programs like welfare, social security and health care require reformulation. A big issue as yet not addressed is how is the United States going to administer the industrial policy which up to now has been carried in the military budget.

The United States still has an unrivaled resource in the depth and wide distribution of research universities. Many of these state universities have strong applied research interests, usually in fields that are closely related to the state's economy. The harnessing of the power to create and innovate of such universities and the transformation of the development arms of the defense department into a civilian advanced project agency are frontiers that the Clinton Administration will have to address as they fully develop what they mean by industrial policy.

The end result of the Clinton administration is likely to be a new model capitalism that takes the model that was built in the 1930's and 40's as a taking off place. This new model will not repudiate nor attempt to dismantle the old new model, which was the aim of Reagan. The new model of capitalism will explicitly recognize that the achievement of a full employment economy will have to come from organizations that are not typical private corporations and not government departments as we have understood them in the United States.

Initially the corporation was a private organization chartered by a special act to carry out a public function. We can expect the new model capitalism to create corporations which mix private and public funding to carry out programs that have a social purpose. We can see glimpses of this in ideas that are floating for health maintenance organizations, for the development of technologies and for community development banking. It is not a matter of picking winners in some technological struggle but rather a matter of defining needs that can be filled with known techniques but which require special organizations to carry them out.

There may well be some experimentation in taxation. The progressive income tax was compromised by Reagan. The argument that income should not be taxed but that consumption is a fairer basis for taxation is gaining some following. It is doubtful whether the political courage

exists to recognize that the logic of a consumption tax requires that the fair rental value of owner occupied housing enter into the base used for the calculation of the tax. However a thorough and logical consumption based tax system would simultaneously reintroduce meaningful progression into the tax system and cut through the confusions relating to pension schemes. As was mentioned earlier, pensions are a policy problem due to the American system of a government Social Security system supplemented by private pension schemes, which are publicly supported by the way taxable income of corporations and households are calculated.

The Clinton Administration is in a tentative way trying to discover the contours of a new model of capitalism: I don't think it is a conscious quest as yet. But as one item in the menu of unmet needs leads to another a new model will emerge which is more explicit in the partnership of public and private agencies in the development of resources than anything we have had in the United States to date.