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**Socialization of Risks without Socialization of Investment:
The Minsky Paradox and the Structural Contradiction of Big Government Capitalism**

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Abstract

A big government sector is indispensable for the normal operations of modern capitalist economy. However, the very success of the big government institutions encourages private investors to engage in excessive risk-taking activities, leading to growing financial fragility and frequent financial crises. The crises necessitate government interventions, forcing the government to run large deficits during recessions. These deficits, however, are not offset by surpluses during expansions. As a result, there is a tendency for the government debt to rise in relation to GDP. The government debt-GDP ratios cannot keep rising indefinitely. Beyond certain point, the debt-GDP ratio could be so high that the government's ability to intervene with and stabilize the economy would be severely undermined. This may be characterized as the structural contradiction of big government capitalism.

JEL Codes

E12; E30; E60; H60

The current economic crisis has generated renewed interest in the works of Hyman Minsky (Papadimitriou and Wray 2008). Minsky argued that modern capitalist economy is inherently unstable and big government institutions (a big government and a central bank functioning as lender of last resort) are indispensable for modern capitalism to achieve an acceptable level of economic stability, and have succeeded in preventing deep depressions (Minsky 2008[1986]).

During recessions, big government deficits help to sustain business profits and create riskless assets (government debt) that help to stabilize the private portfolios. The central bank, acting as lender of last resort, set floors under the prices of assets. Both institutional arrangements help to break the economy's downward spirals and prevent recessions from descending into deep depressions.

However, big government institutions have strong side effects. Big government deficits in effect help to socialize business losses, and the central bank's lender of last resort actions in effect help to socialize risks of private financial markets. Despite the partial socialization of risks and losses, under big government capitalism, investment decisions continue to be made by private businesses for the purpose of making private profits. Big government capitalism thus encourages excessive risk-taking in finance and investment and tends to increase the potential of financial instability.

Thus, on the one hand, big government institutions are indispensable for preventing depressions. On the other hand, big government capitalism does not abolish the inherent tendency under capitalism towards financial fragility. On the contrary, with the effective socialization of risks and losses, there is a tendency for the financial fragility to intensify, with increasingly destabilizing consequences. Pollin and Dymski (1994) referred to this contradiction as the "Minsky Paradox".

Pollin and Dymski reviewed the empirical evidence that compared the economic performance of small government and big government capitalism. They argued that while big

government capitalism had succeeded in preventing depressions, the costs of the necessary government interventions had tended to rise, reflected in higher unemployment, higher inflation, and more frequent and violent financial crises. As the costs of big government interventions increasingly approached and potentially could outweigh the benefits, big government capitalism could eventually become unsustainable.

This paper begins with an updated analysis that compared the economic and financial indicators of three phases of American capitalism: small government, early big government, and neoliberalism. The analysis confirms Pollin and Dymski's findings that in the neoliberal era, despite the continuing presence of big government institutions, the underlying financial structure has become more unstable.

The paper then applies the Kaleckian-Minskian macroeconomic identity to the US economy. It is observed that under big government capitalism, while the government has to run large primary deficits during the recessions, the deficits are usually not offset by sufficiently large primary surpluses during the expansions. As a result, there has been a tendency for the government debt to rise in relation to GDP.

The current crisis is set to be followed by a massive surge of the US federal government debt. Government debt cannot rise forever in relation to GDP. At some point, excessively high debt-GDP ratio could seriously undermine the government's capacity to intervene with the economy. In that event, capitalism may lose the ability to maintain an economically and socially acceptable level of economic stability, and the long-term viability of the system would be in question.

This paper concludes by arguing that the required socialization of investment cannot take place within the basic framework of the capitalist system. For the structural contradiction of big government capitalism to be resolved, it may require nothing short of a fundamental social transformation that brings about the comprehensive socialization of the basic means of production.

Stabilizing an Unstable Economy

In *Stabilizing an Unstable Economy*, Minsky discussed how the US economy had evolved in the postwar years. During the relative tranquil period of the 1950s and 1960s, the US financial structures had become increasingly fragile. From the late 1960s to the 1970s, the US economy was hit by successive financial crises. During each crisis, as the Federal Reserve undertook lender of last resort actions, it legitimized certain new financial institutions or new financial instruments, increasing the effective quantity of liquid assets as well as the economy's overall financing capacity. Further, big government deficits helped to sustain private profits and stabilize private portfolios. A recession was thus soon followed by a new round of inflationary investment boom, leading to a new crisis. The progressive deepening of financial instability culminated in the threat of a general flight from the dollar in 1979 and the deep recessions of 1980-1982 (Minsky 2008: 13-106).

In the 1980s and the early 1990s, the high government deficits under the Reagan and elder Bush administrations helped to maintain profits at relatively high levels and contain a series of financial crises (the saving and loans crisis and the stock market crash of 1987). By the mid-1990s, inflation was considerably moderated, the US economy seemed to have entered into a permanent "new economy" boom, and the stock market was enjoying the "irrational exuberance".

As inflation seemed to have been tamed, financial instability did not disappear. Instead, it has found new expressions in successive asset bubbles. During the 2001 recession, instead of allowing the stock market bubble to collapse, the Federal Reserve under Greenspan responded with a massive increase in money supply and the federal government budget swiftly shifted from a surplus to a large deficit. The 2001 recession turned out to be relatively mild. Confidence quickly returned to the financial market. Abundant liquidity and a new wave of financial innovations soon fueled an even bigger housing bubble (Papadimitriou and Wray 2008).

But what is unsustainable cannot be sustained. As the housing bubble developed, both the internal and external imbalances of the US economy continued to widen. The imbalances could not keep expanding forever and had to be corrected at certain point. The bubble eventually collapsed more or less under its own weight. The US economy has since then been struggling with the deepest recession in the postwar history.

Table 1 presents the economic and financial indicators of the US economy under three institutional structures: small government, early big government, and neoliberalism. This is an updated reproduction of Pollin and Dymski's empirical analysis (Pollin and Dymski 1994: 378, Table 1). In this case, the "early big government" era refers to the Keynesian, "new deal" era of big government capitalism. On the other hand, under neoliberalism, big government institutions (big government spending and central bank as lender of last resort) have continued to operate. Thus, neoliberalism may be seen as the second stage of big government capitalism.

For each institutional structure, Table 1 only includes periods when the prevailing institutions were in "normal" operations. Thus, both the Great Depression and the Second World War are excluded. Each institutional era begins with a post-recession year and ends with a peak year in business cycle expansion.

Figure 1 presents the US federal government expenditures as ratios of GDP and the US economic growth rates from 1870 to 2009. The federal government expenditures averaged only 3 percent of GDP in the years before the Great Depression. The size of the federal government gradually increased from the 1930s to the 1960s and since then has stabilized at around 20 percent of GDP.

In term of average economic growth rate, the neoliberal era has had the worst performance in three institutional structures. But when growth is measured by growth rate of per capita GDP, the neoliberal era's performance is better than that of the small government era and roughly comparable to that of the early big government era.

The apparent similarities in average growth performance disguise fundamental changes in underlying economic behavior. Small government capitalism was characterized by the regular recurrence of deep depressions. Big government capitalism has been much more stable and growth rates have been fluctuating within a much narrower range.

The early big government era had the lowest average unemployment rate. The average unemployment rate in the neoliberal era is similar to that of the small government era.

If the high inflation rates during the First World War were excluded, then in average there had been virtually no inflation under small government capitalism. The early big government era saw significantly higher inflation rates. In the neoliberal era, the inflation rate has fallen back to relatively low levels.

The real interest rate is a measure that reflects the level of financial risks. Business and bank failures rates directly measure the bankruptcy risks in the general business and the banking sector. The early big government era was characterized by low real interest rates and low business failure rates, with virtually no bank failures. The early big government era had a much more stable business and financial environment than the small government era.

In the neoliberal era, both the business failure and the bank failure rates have approached those found in the small government era (the business and bank failures of the current recession have not yet been included). The average real interest rate in the neoliberal era is not only high in term of absolute level, but also significantly higher than the average economic growth rate, implying tendencies for debt-income ratios to rise for debtors.¹

Thus, under big government capitalism, government interventions have (so far) succeeded in preventing depressions. However, the very success of government interventions

¹ From equation 3 in the section on “The Debt Dynamics” (see below), it can be derived that if the debtor’s primary balance is either in balance or deficit, and if the interest rate is higher than the income growth rate, then the debt-income ratio tends to rise.

has encouraged the private investors to undertake excessive risks and the underlying financial fragility has tended to increase over time. In the 1970s, the growth of financial fragility contributed to rampant inflation. Since then, it has found expressions in successive asset bubbles. In either case, the growth of financial fragility eventually ended with a series of financial crises, and from time to time, the US economy fell into deep recessions.

These observations raise the question whether there is a limit to this contradictory process. As the big government institutions repetitively intervene to prevent the economy from falling into outright depressions, are we steadily approaching a point beyond which big government capitalism could have exhausted its capacity to stabilize the economy?

Profit and Instability

Minsky emphasized the importance of the profit in the operation of the capitalist economy. This emphasis is similar to the Marxist analysis of capitalist accumulation.

For Minsky, the current level of profits helps to form the business views about the future, which in turn determine the level of investment. Moreover, as much of private investment is financed by debt, the profits are essential for generating the cash flows necessary for the validation of existing business debt (Minsky 2008: 30-37). Thus, the level of profit is a major determinant of the level of investment and, through investment, a major determinant of the overall economic activity.

Following Michael Kalecki, Minsky saw profits as being determined by the sum of aggregate demand components in excess of wages and taxes (Minsky 2008: 160-169).

Consider the following macroeconomic identity:

$$C + I + G + (X-M) = W + \Pi + T \tag{1}$$

The left side of the equation includes all components of aggregate demand: consumption (C), private investment (I), government spending on goods and services (G), and net exports (X-M). The right side of the equation includes all components of national income: total wages (W), total profits (Π), and taxes (T). By definition, total national expenditures must equal total national income.

Rearrange the terms:

$$\Pi = I + (C-W) + (G-T) + (X-M) \quad (2)$$

That is, the profits are determined by the sum of private investment, private consumption in excess of wages (roughly corresponding to household sector primary deficit), government primary deficit, and net exports. If the household sector and foreign trade are in rough balance, then the profits are primarily determined by investment and government deficit.

Under small government capitalism, a fall of investment leads to fall of profits, leading to further declines of investment and household spending. The downward spiral could easily descend into a deep depression. Under big government capitalism, as investment falls during a recession, the government runs large deficits offsetting the fall of investment. Despite recession, capitalist profits are sustained and deep depression is prevented.

However, as the government runs deficits during recessions, government debt will increase. To maintain a sustainable fiscal position, the government needs to generate corresponding surpluses during expansions. Otherwise, the government debt could rise to unsustainable levels in the long run.

The Debt Dynamics

Minsky considered the conditions required for government debt sustainability:

A government can run a deficit during a recession without suffering a deterioration of its creditworthiness if there is a tax and spending regime in place that would yield a favorable cash flow (a surplus) under reasonable and attainable circumstances.

There is nothing special about government debt, and a flight from government debt can occur. For a foreign-held debt such a flight will lead to a deterioration of the currency on the exchanges; for a domestic debt the flight can lead to inflation and a need to pay even higher interest rate to have the debt held.

Incidentally, if the central bank – the Federal Reserve – monetizes government debts in order to maintain its nominal price in the face of a deteriorating willingness to hold such debt, then there can be a run from the Federal Reserve as well as from commercial bank liabilities. Just as private business debts have to be validated by profits, as bank liabilities by receipts from assets, as a foreign debt by an export surplus, so government debt has to be validated by an excess of tax receipts over current expenditures (Minsky 2008[1986]: 336-337).

In the long run, debt should stabilize relative to income and the debtor's regular borrowing requirements (structural deficits) need to be sufficiently small so that they can be readily accommodated by potential lenders.

If the government debt keeps rising relative to GDP, then given certain interest rate, the government will be forced to borrow a growing amount in relation to national income to meet interest payment requirements. This is a trend that cannot be sustained indefinitely, and eventually has to be halted and reversed.

Consider the following formula, where D stands for government debt, Y stands for GDP, and "i" stands for interest rate:

$$\begin{aligned}\Delta(D/Y) / (D/Y) &\approx \Delta D / D - \Delta Y / Y \\ &= (\text{Primary Deficit} + D * i) / D - \Delta Y / Y\end{aligned}$$

$$= \text{Primary Deficit} / D + i - \Delta Y / Y \quad (3)$$

Thus, change in the government debt-GDP ratio depends on the government's primary balance (the government fiscal balance before interest payments), the interest rate, and the economic growth rate. If the interest rate roughly equals economic growth rate, then when the government runs primary deficit, the government debt tends to rise relative to GDP. Conversely, when the government runs primary surplus, the government debt tends to fall relative to GDP.

Profit and Instability: Empirical Evidence

Figure 2 presents the profit rate and the economic growth rate in the US economy for the period 1929-2008. The profit rate is measured by the ratio of the profit (total after-tax property incomes) over the capital stock. Economic growth rates are in three-year moving averages.

The movements of the economic growth rates mostly parallel those of the profit rate. After the collapse in the 1930s, the profit rate surged during the Second World War. The profit rate reached another peak in the mid-1960s before suffering from sustained declines from the late 1960s to the early 1980s. The fall of the profit rate corresponded to the economic crises in the 1970s and the early 1980s.

The profit rate tended to rise from the early 1980s to the mid-1990s. From 1997 to 2006, the profit rate stayed on a high plateau. The current crisis is likely to represent the beginning of a prolonged period of declining profit rate and economic difficulties.

The profit rate is determined by the profit share (that is, the profit-output ratio) and the output-capital ratio. Following the Kaleckian-Minskian macroeconomic identity (see equation 2 above), Figure 3 presents the determinants of the profit share: the private sector excess spending (the sum of private consumption and investment less wages), government deficits, and net exports (including statistical discrepancies).

In the postwar years, the profit has mostly fluctuated around 15 percent of GDP.

The differences between the private sector excess spending and the profit represent private sector primary deficits. In most years, the private sector spending and incomes were in rough balance. But there were some significant exceptions. During the Second World War, the private sector ran huge surpluses. The negative impacts on the profits were offset by huge government deficits. During the early postwar years, the release of the wartime savings led to large private sector deficits. During the crisis of 1975, 1982, and 1991-92, the private sector had significant surpluses. However, since the early 1990s, the US private sector has experienced large, sustained, and unprecedented deficits.

In the early postwar years, the US enjoyed substantial trade surpluses. From the 1950s to the early 1970s, the US trade sector fluctuated between small surpluses and small deficits. Since the late 1970s, the US has been running increasingly larger trade deficits, reaching about 6 percent of GDP before the current crisis.

The US government sector stayed in rough balance from the early 1950s to the early 1970s. From the late 1970s to the early 1990s, the US government sector ran substantial deficits. The government sector moved into surpluses during the late 1990s boom. But the surpluses were not large enough to offset the deficits accumulated over the previous years. Since the 2001 recession, the government has been consistently running large deficits.

Neoliberalism and Government Debt

Equation 3 shows that change in the government debt-GDP ratio depends on the government sector's primary balance, the interest rate, and the economic growth rate. Figure 4 compares the effective nominal interest rate paid by the government with the nominal growth rate of GDP for the US economy from 1950 to 2008.

From the 1950s to the 1970s, the interest rates consistently stayed below economic growth rates, often with large margins. However, since the 1980s, the interest rates and the economic growth rates have been fluctuating around roughly similar levels. The changing

relationship between the interest rate and the economic growth rate reflects fundamental changes in underlying economic institutions.

In response to the dollar crisis of 1979, the Federal Reserve sharply raised the short-term interest rate. Since then, monetarism had become the new orthodox economic doctrine. Under monetarism, the monetary policy was conducted solely for the purpose of maintaining price stability. In practice, monetarist policy usually meant maintaining excessively high interest rate at the expense of employment and economic growth.

While monetary policy certainly contributed to the high interest rates in the 1980s, it cannot explain why the interest rates have remained relatively high (in relation to economic growth rates) in the 1990s and early 2000s when inflation rates seemed to have been tamed.

Pollin and Dymski (1994) argued that the high interest rates in the neoliberal era reflected the increase in the underlying financial instability. Lenders demanded higher interest rates to compensate for the higher risks. Felix (1998) argued that the liberalization of international financial markets had led to the high interest rates. Liberalization increased the possibility of financial crisis and massive capital flight. To discourage capital flight and maintain currency values, central banks have been pressured to maintain relatively high interest rates.

As the interest rate becomes roughly comparable to the economic growth rate, the trend of the government debt-GDP ratio depends primarily on the cumulative government primary balances. As Minsky argued, with big government institutions, private risks and losses were partially socialized. The socialization of risks encourages excessive risk taking that has led to successive, and increasingly more violent, financial crises. The crises necessitate interventions by big government institutions, forcing the government to run large deficits during recessions. Unless these deficits are offset by comparable surpluses during subsequent expansions, the government debt-GDP ratio inevitably tends to rise.

In reality, since the late 1970s, the US government sector has never run sustained and substantial surpluses with the exception of the late 1990s.

Tendency for the Debt-GDP Ratio to Rise?

Figure 5 presents the historical and projected US federal government debt as ratios of GDP.

During the Second World War, the US federal debt exceeded 100 percent of GDP. In the early postwar years, the US, government sector ran large surpluses. Since then, the US government sector had been in rough fiscal balance. As the Federal Reserve kept the interest rates substantially below the economic growth rates, the debt-GDP ratio fell rapidly from the 1950s to the 1970s.

From the 1970s to the 1980s, the US government intervened during successive financial crises. The debt-GDP ratio rose steadily from the late 1970s to the early 1990s. The debt-GDP ratio fell during the late 1990s boom but tended to rise again during and after the 2001 recession.

Given the current crisis and the massive government bailout and stimulus programs it necessitates, the federal government debt-GDP ratio is projected to rise sharply in the coming years, perhaps approaching 100 percent of GDP by around 2020. The Congressional Budget Office projects that under the current laws and policies, the federal government debt could potentially reach 300 percent of GDP by the mid-21st century (CBO 2009).

The Congressional Budget Office's projections emphasize the impact of population aging and rising healthcare costs. However, if this paper's arguments are valid, then even without considering these structural factors, there may be a secular tendency for the government debt-GDP ratio to rise under the combination of neoliberal and big government institutions.

With liberalized financial markets (especially with free cross-border flows of capital), the interest rate is likely to remain relatively high in relation to the economic growth rate. With big government institutions and socialization of risks, private risk takings tend to increase financial fragility, leading to financial crisis necessitating government interventions. As government

deficits during recessions are not offset by surpluses during expansions, the government debt inevitably tends to rise relative to GDP.

Government debt cannot rise indefinitely relative to GDP. At some point, the interest payments required would become so large that the potential lenders (the private and the foreign sector) are no longer willing or able to accommodate the borrowing requirements. In that event, the government would be forced to raise taxes or reduce spending, thus undermining its capacity to intervene during financial crises. Alternatively, if debt is monetized, it could lead to a general flight from the currency, leading to runaway inflation.

Is it possible for this tendency towards rising debt-GDP ratio to be halted or reversed without fundamental changes of existing institutions?

First, the tendency of rising debt can be attenuated or even reversed if the interest rate can be kept sufficiently low relative to the economic growth rate. However, as explained above, unless fundamental changes in international financial markets take place to substantially limit the freedom of capital movements across national borders, policies to restrain the interest rate risk undermining the national currency and could possibly trigger massive capital flight.

Second, the tendency may be reversed if the government sector could manage to run sustained, substantial surpluses during economic expansions.

From equation 1 or 2, the following equation can be derived:

$$T-G = (C+I-W-\Pi) + (X-M) \tag{4}$$

That is, the government primary surplus is determined by the sum of the private sector deficit and trade surplus. In other words, the government could run a surplus if either the private sector runs a deficit or there is a trade surplus or there is a combination of the two.

The US seems to have suffered from structural trade deficits since the 1980s. The current US trade deficits mainly consist of manufacturing deficits and oil imports. Manufacturing

deficits partially reflect the relocation of certain manufacturing industries to cheap labor zones. Oil imports result from the declining domestic oil production and the structural high demands for oil. Neither of the two factors is likely to be corrected in the near term.

In addition, under neoliberalism, much of the global economy suffers from insufficient domestic demand and relies upon exports as the leading sector for economic growth. But for export-oriented economies to run trade surpluses, there must be one or several large economies willing to run corresponding trade deficits. To the extent the rest of the world fails to stimulate internal demand, the US has to run large trade deficits to sustain global effective demand.

Even if somehow the US trade sector manages to return to balance in the coming years, for the government to run surpluses during expansions, it would still require the private sector run sustained deficits. Since the 1950s, the US private sector has only run sustained, large deficits during the late 1990s and the early 2000s, a period of irrational exuberance which culminated in the current financial breakdown.

There may also be political obstacles to running sustained government surpluses. During expansions, elected officials are likely to be under political pressures to increase spending or lower taxes, making it unlikely for surpluses to be sustained.

The problem for American capitalism may be illustrated with a numerical example. The postwar experience has suggested that normally the profit share of GDP needs to be about 15 percent for the US capitalist economy to function well. Suppose the private sector spending is also about 15 percent of GDP so that the private sector is in financial balance. If the trade deficit is about 5 percent of GDP, then the government sector has to run a primary deficit of about 5 percent of GDP to sustain the required profit level.

The Structural Contradiction of Big Government Capitalism

A big government sector is indispensable for the normal operations of modern capitalist economy. However, the very success of the big government institutions encourages private

investors to engage in excessive risk-taking activities, leading to growing financial fragility and frequent financial crises.

The crises necessitate government interventions, forcing the government to run large deficits during recessions. These deficits, however, are not offset by surpluses during expansions. As a result, there is a tendency for the government debt to rise in relation to GDP. The tendency is intensified under neoliberalism as interest rates tend to be relatively high in relation to economic growth rates.

The government debt-GDP ratios cannot keep rising indefinitely. Beyond certain point, the debt-GDP ratio could be so high that the government's ability to intervene with and stabilize the economy would be severely undermined. This may be characterized as the structural contradiction of big government capitalism.

At this point, it is not possible to know how this contradiction will exactly evolve and develop in the future. However, if at certain point, the government debt becomes prohibitively large relative to GDP, then one of the following outcomes could happen.

Under the first possibility, when the government debt-GDP ratio becomes too high, if the economy is hit by a financial crisis and private spending collapses, concerned with the sustainability of government debt, the government may hesitate to intervene and the necessary fiscal interventions may be too little, too late. In that case, a recession would be deeper than it otherwise would be and could even turn into a depression.

Under the second possibility, when the government debt-GDP ratio becomes too high, as the economy recovers from a recession, a government that is concerned with debt sustainability may pre-maturely raise taxes or lower spending, sending the economy back to recession. A capitalist economy with very high government-debt GDP ratios thus may suffer from persistent stagnation, as vigorous economic expansion never materializes.

Thirdly, the excessively high government debt-GDP ratio itself could trigger a financial crisis. If private investors lose confidence in the sustainability of a government's debt, the

market value of the debt could collapse, forcing the interest rate to surge. If the central bank decides to monetize the government debt, it could trigger a massive capital flight and a currency crisis.

In *Socialism: Utopian and Scientific*, Engels (1978[1880]) argued that the basic contradiction of capitalism had to do with the contradiction between the objective tendencies towards socialization of production and the capitalist system of private appropriation. According to Engels, this contradiction would lead to increasingly more destructive economic crises and force capitalism to adopt increasingly socialized forms of economic organizations, such as modern corporations and state regulations. However, Engels believed that ultimately the contradiction could only be resolved through fundamental changes that would bring about the social ownership of the basic means of production.

From this Marxist perspective, the structural contradiction of big government capitalism or the so-called Minsky Paradox exactly reflects the underlying contradiction between the capitalist system of private appropriation and the objective processes of socialization of production. While the development of the capitalist economy requires growing social regulations through institutions such as the big government and the central bank, the basic means of production continue to be owned by private capitalists and used by private capitalists to make private profits. This underlying contradiction will inevitably find its expressions through changing forms of, and perhaps progressively more destructive, economic crises. The important question is if this underlying contradiction can be resolved, or sufficiently alleviated, within the basic institutional framework of capitalism.

In *The General Theory*, John Maynard Keynes argued that capitalist investment was fundamentally unstable and moreover, the development of capitalist financial markets was likely to have further intensified investment instability (Keynes 1964[1936]: 147-164). Keynes doubted the effectiveness of the monetary policy in stabilizing the capitalist economy. Towards the end of *The General Theory*, Keynes proposed that “a somewhat comprehensive socialisation

of investment will prove the only means of securing an approximation of full employment” (Keynes 1964[1936]: 378). However, Keynes insisted that:

But beyond this no obvious case is made out for a system of State Socialism which would embrace most of the economic life of the community. It is not the ownership of the instruments of the production which it is important for the State to assume. If the State is able to determine the aggregate amount of resources devoted to augmenting the instruments and the basic rate of reward to those who own them, it will have accomplished all that is necessary (Keynes 1964[1936]: 378).

In their analysis of the Minsky Paradox, Pollin and Dymski (1994) pointed out that the underlying problem was that, while the costs and risks of investment had been socialized, the basic investment decisions remained in the private hands. Inspired by Keynes, they argued that the problem could only be solved through some form of socialization of investment, conducted through “democratic economic planning”.

Inspired by the Japanese experience, Pollin and Dymski proposed credit allocation policies as an instrument to implement socialization of investment. Recognizing that credit allocation could also lead to rent-seeking and mismanagement, they emphasized the necessity to build a system of democratic accountability and regulations.

The credit allocation policies are not intended to be incompatible with a financial system dominated by privately owned financial institutions. Moreover, the basic investment decisions remain in the hands of private financial or nonfinancial capitalists. In this sense, credit allocation, even with quite substantial government supervisions, does not fundamentally address the underlying contradiction between the effective socialization of investment risks without a socialized control over investment.

The Japanese experience since the 1990s has revealed that a capitalist economy with substantial state guidance and corporatist structures could nevertheless suffer from a high level

of financial instability. In the Japanese case, the bursting of the asset bubbles has been followed by prolonged deflationary stagnation and overwhelming levels of government debt.

Moreover, so long as the underlying economic system remains basically capitalistic and most of the economic wealth as well as political power is concentrated in a small group of capitalist elites, there may be insurmountable political obstacles to the kind of democratic accounting and democratically regulated investment envisioned by Pollin and Dymski.

Thus, on the one hand, a high level of socialization of investment risks and losses has become indispensable for the normal operations of modern capitalism. On the other hand, the lack of social control over investment had led to growing financial instability and increasingly larger government debts, two processes that cannot be sustained indefinitely. Moreover, it seems to be rather difficult, if not impossible, to develop a reasonable mechanism of socialization of investment without compromising the basic framework of capitalism. Contrary to what Keynes argued, the eventual resolution of this structural contradiction may require nothing short of a comprehensive socialization of the basic means of production.

Of course, the historical experience of the 20th century has demonstrated that the building of a socialist system based on political and economic democracy is by no means easy. On the other hand, if the structural contradiction of big government capitalism cannot be resolved within the capitalist framework, it raises fundamental questions regarding the long-term viability of capitalism.

In Chapter 1 of *Stabilizing an Unstable Economy*, Minsky made the following comments:

It may also be maintained that capitalist societies are inequitable and inefficient. But the flaws of poverty, corruption, uneven distribution of amenities and private power, and monopoly-induced inefficiency ... are not inconsistent with the survival of a capitalist economic system. ... A capitalist economy cannot be maintained, however, if it oscillates between threats of an imminent

collapse of asset values and employment and threats of accelerating inflation and rampant speculation, especially if the threats are sometimes realized (Minsky 2008[1986]:6).

The failure to resolve the structural contradiction of big government capitalism would exactly lead to the kind of oscillation between two different, but equally unacceptable threats described by Minsky. In that event, socialism may very well turn out to be the most desirable among all the conceivable alternatives to capitalism.

Appendix: Data Sources and Construction

Federal Government Expenditures and Nominal GDP

US federal government expenditures for 1870-1933 are from *Historical Statistics of the United States*, Table Ea 636-643. Nominal GDP for 1870-1929 is from *Historical Statistics of the United States*, Table Ca 9-19.

Federal outlays as percent of GDP for 1934-2008 are from *Economic Report of the President*, Table B-79.

Real GDP and Per Capita Real GDP

Real GDP and per capita real GDP for 1870-1929 are from *Historical Statistics of the United States* (Carter et al. 2006), Table Ca 9-19.

Real GDP for 1929-2008 is from Bureau of Economic Analysis, *National Income and Product Accounts Tables* (<http://www.bea.gov/national/nipaweb/SelectTable.asp?Selected=N>), Table 1.1.6. US population for 1929-2008 is from *Economic Report of the President* (<http://www.gpoaccess.gov/eop/>), Table B-34.

Unemployment Rate

Unemployment rates for 1890-1959 are from *Historical Statistics of the United States*, Table Ba 470-477. Unemployment rates for 1960-2008 are from *Economic Report of the President*, Table B-42.

Inflation Rate

Inflation rate is defined as the rate of change of GDP deflator.

GDP deflator for 1870-1929 is from *Historical Statistics of the United States*, Table Ca 9-19. GDP deflator for 1929-2008 is from *National Income and Product Accounts Tables*, Table 1.1.9.

Real Interest Rate

Real interest rate is the difference between the nominal corporate interest rate and the inflation rate.

Railroad bond yields for 1870-1919 and corporate high-grade bond yields for 1919-1929 are from *Historical Statistics of the United States*, Table Cj 1192-1197. Corporate Aaa bond yields for 1929-2007 are from *Economic Report of the President*, Table B-73.

Business Failures

Business failures per 10,000 firms for 1870-1998 are from *Historical Statistics of the United States*, Table Ch 408-413.

For 1999-2005, business failure rates are estimated using the number of business bankruptcies and the number of employer firms. The data are from the US Census Bureau, *The 2009 Statistical Abstract* (<http://www.census.gov/compendia/statab/>), Table 738, 742, and 746.

Bank Failures

Bank suspensions and the number of all banks for 1870-1933 are from Bureau of the Census (1975), Series X 580-587 and X 741-755.

Bank failures and the number of commercial banks for 1934-2007 are from Federal Deposit Insurance Corporation, *Historical Statistics on Banking, Commercial Bank Reports* (<http://www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=10>), Table CB 01 and 02.

The Profit

The US economy-wide profit is defined as the sum of net interest and miscellaneous payments, net business current transfer payments, 50% * proprietors' income, rental income, and corporate profits, less estimated personal income taxes on the profit incomes.

Data for profit incomes for 1929-2008 are from *National Income and Product Accounts Tables*, Table 1.10. Personal income taxes are from *National Income and Product Accounts Tables*, Table 2.1.

Capital Stock

Capital stock is measured by net stock of private non-residential fixed assets. Data for 1925-2007 are from Bureau of Economic Analysis, *Fixed Assets Tables* (<http://www.bea.gov/national/FA2004/SelectTable.asp>), Table 1.1.

GDP and Expenditures

Gross domestic product, personal consumption, private investment, net exports, and government consumption and investment for 1929-2008 are from *National Income and Product Accounts Tables*, Table 1.1.5.

Both private and government investment are net of consumption of fixed capital.

Wages

Total wages is defined as the sum of compensation of employees, 50% * proprietors' income, and government social benefits, less contributions for government social insurance and estimated personal income taxes on wages.

Incomes data are from *National Income and Product Accounts Tables*, Table 1.10. Government social benefits and contributions for government social insurance are from *National Income and Product Accounts Tables*, Table 3.1.

Government Primary Deficit

Government primary deficit is defined as government consumption and investment less government primary revenue.

Government primary revenue is defined as the sum of taxes on production and imports less subsidies, personal taxes on wages and profits, current surplus of government enterprises, and contributions for government social insurance, less government social benefits.

Government revenue and expenditures data for 1929-2008 are from *National Income and Product Accounts Tables*, Table 3.1.

Effective Interest Rate for the Government Sector

Effective interest rate for the government sector is defined as the ratio of the government interest payments to the general government debt.

Government interest payments for 1950-2008 are from *National Income and Product Accounts Tables*, Table 3.1. General government debt for 1950-2008 is from *Flow of Funds Accounts of the United States* (<http://www.federalreserve.gov/releases/z1/Current/data.htm>).

Historical and Projected Federal Government Debt

US federal government debt for 1900-1961 is from *Historical Statistics of the United States*, Table Ea 650-661. Nominal GDP is from *Historical Statistics of the United States*, Table Ca 9-19.

Historical federal government debt to GDP ratios for 1962-2008 and projected ratios for 2009-2050 under the “alternative policy scenario” are from CBO (2009).

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Table 1

Economic and Financial Indicators of American Capitalism, 1875-2007

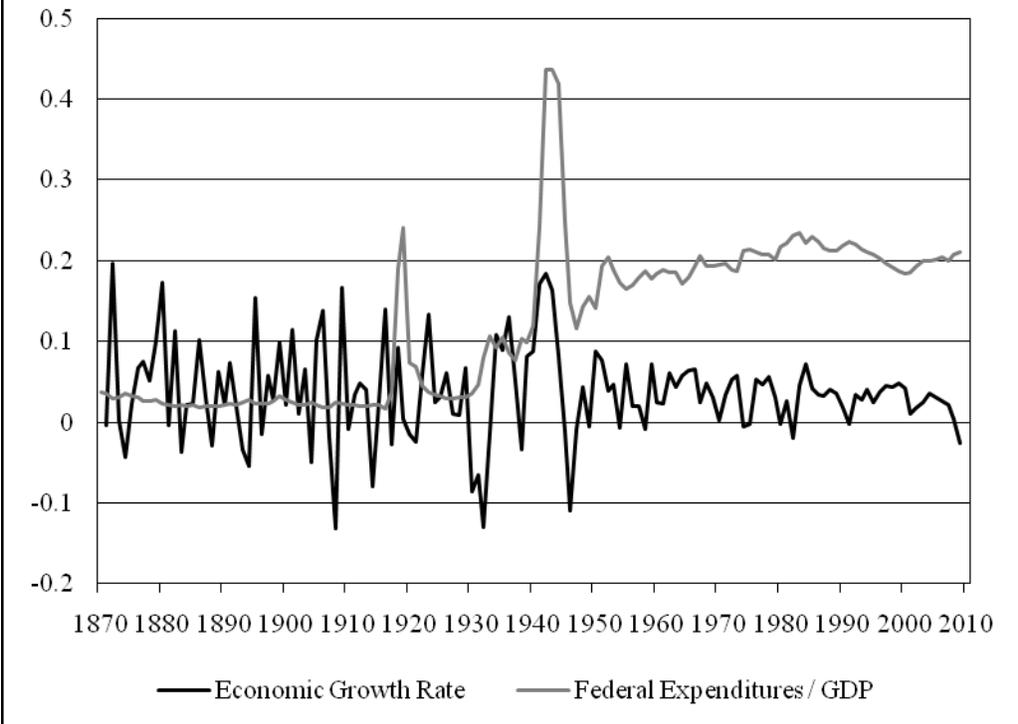
	Small Government (1875-1929)	Early Big Government (1948-1979)	Neoliberalism (1983-2007)
Fed. gov. expenditures as % of GDP	3.3	18.7	20.8
Ave. ann. growth rate of real GDP	3.8	3.8	3.3
Ave. ann. growth rate of per capita real GDP	1.9	2.4	2.2
Unemployment rate	5.6 ^a	5.2	5.8
Inflation rate	1.0	3.7	2.6
Real interest rate	3.8	1.6	5.5
Business failures per 10,000 firms	100	42	86 ^b
Bank failures per 10,100 banks	106	5	70

^a 1890-1929.

^b 1983-2005.

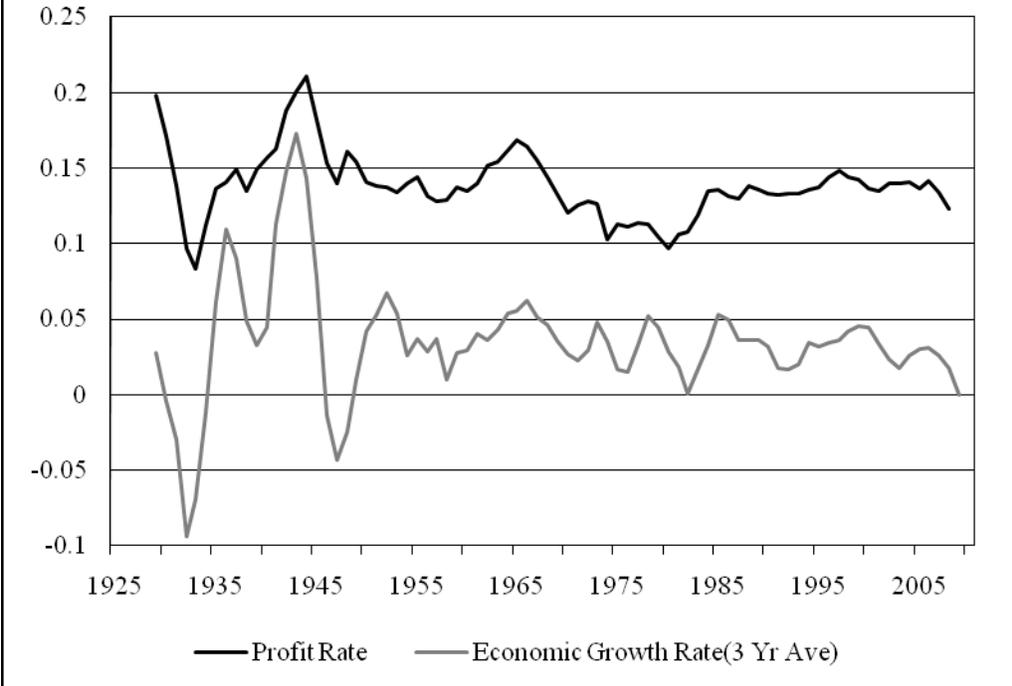
Sources: see Appendix.

Figure 1
US Government and the Economy, 1870-2009



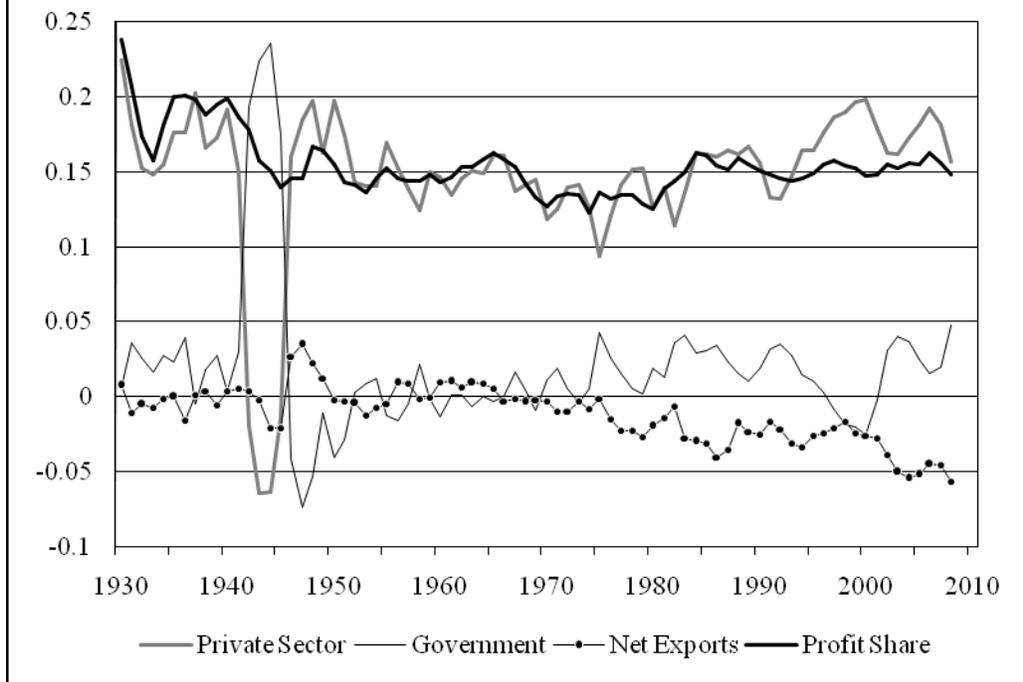
Sources: see Appendix.

Figure 2
Profit Rate and Economic Growth
(US Economy, 1929-2009)



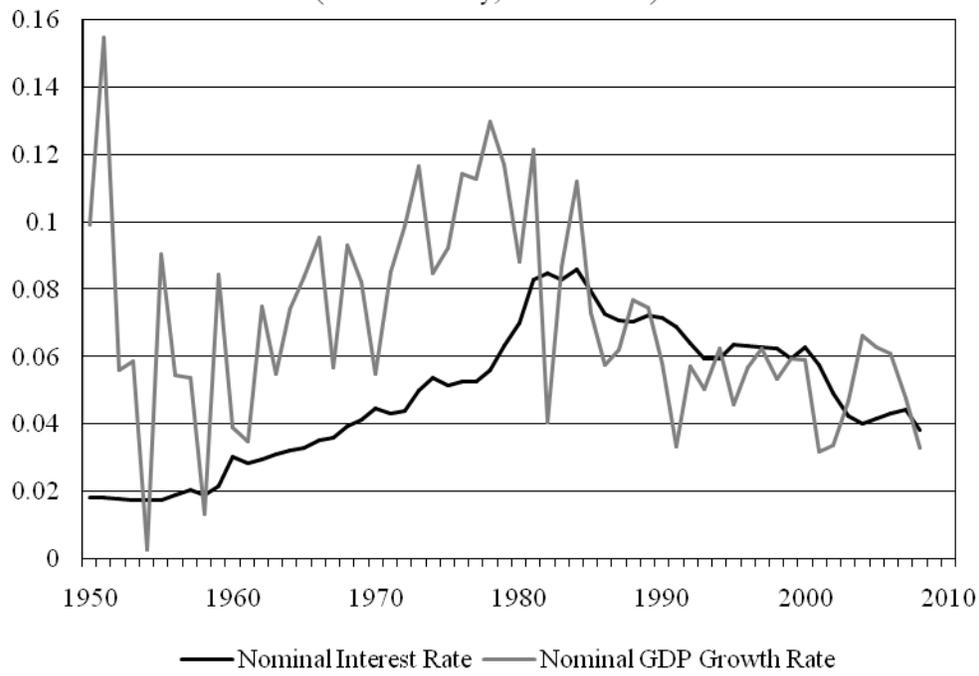
Sources: see Appendix.

Figure 3
Determinants of Profit Share
(US Economy, as Ratios of GDP, 1930-2008)



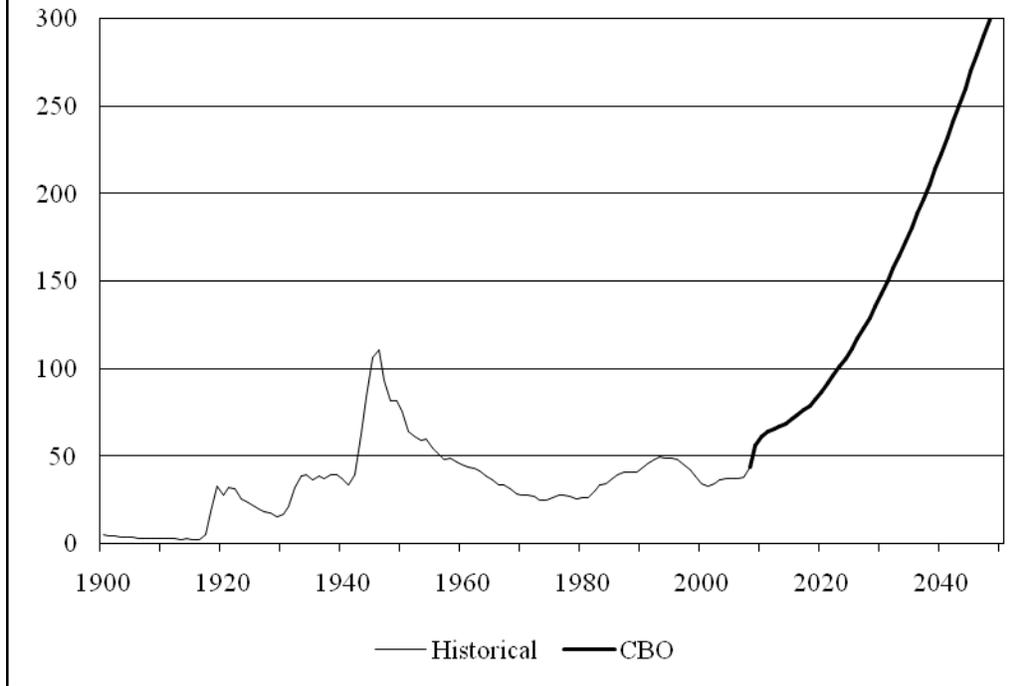
See: see Appendix.

Figure 4
Interest Rate and Nominal GDP Growth Rate
(US Economy, 1950-2008)



Sources: see Appendix.

Figure 5
US Federal Government Debt
(Held by the Public, Percent of GDP, 1900-2050)



Sources: see Appendix.