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It's Not a Minsky Moment, It's a Minsky Era, Or: Inevitable Instability

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[LINK TO ABSTRACT](#)

The economist Hyman P. Minsky wrote extensively and prolifically throughout the latter half of the 20th century. Hardly anybody listened.² When the storm broke in 2007 a number of financial journalists discovered, or thought they had discovered, him and his work and began to talk about a 'Minsky Moment' without showing awareness of what Minsky was really about.³

The present paper discusses some of Minsky's work and its development over the decades and argues that 'Minsky Moment' is a misnomer. We are in a Minsky Era. The concept of a sudden crash and panic in financial markets, as described by Walter Bagehot and others since, is not what Minsky was about. He

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2. Major exceptions emanate from Annandale, New York, where the Levy Institute at Bard College was Minsky's host and professional home for the last six highly productive years of his life, and Kansas City, Missouri, where his former student Randall Wray is the center of activity of a research group and conferences. There is also a great deal of interest in his work in Italy, particularly in Bergamo. In addition there were a number of interesting and interested reviews in earlier years. For example, Harcourt (1977) is perceptive and succinct: "Minsky combines the institutional settings of [Keynes's] *Treatise* with the analytical concepts of the *General Theory*, especially of Chapter 17, to show that there is a coherent story of the cycle implicit in Keynes. One short-run state carried within itself the ingredients of an inevitable transition to the next in a definite sequence." Another such review is Tobin (1989). But other than reviews I find very little work involving a discussion (pro or con) of his ideas. Astonishingly, even Paul Davidson (2007) in his fine biography of Keynes does not reference Minsky in his index or bibliography.

3. An outstanding exception is Martin Wolf (admittedly not a run-of-the-mill financial journalist). Wolf (2012) shows an understanding and appreciation that Minsky's work as expressed in *Stabilizing an Unstable Economy* involves a process, not an accidental or incidental 'moment.'

was concerned with the ongoing behavior of agents in financial markets, primarily banks, systematically behaving in a way that leads to increasingly speculative activity followed, virtually inevitably, by a crash.⁴ The process by which this occurs, involving the relationship between banks and their customers, was the subject of his analysis. As time went on during the 20th Century, the role of banks changed, and other institutions such as mutual funds to great extent took their place. This too was subject to his analysis. Minsky knew and understood what was happening ‘on the street’ and within banks better, I am convinced, than any of his contemporary academic economists. He was consultant to the Comptroller of the Currency and was for thirty years the director of a bank.⁵ Trained in mathematics and analytical economics, he was nevertheless aware of, and deeply concerned with, what was happening in ‘real life.’

This paper describes and discusses Minsky’s ideas and the trajectory of his thinking, which evolved as events and institutions (and hence appropriate policy) changed from the 1970s up to the time of his death in 1996. His theoretical and ideological outlook, however, remained essentially the same. The paper aims to bring some of his work to the attention of the mainstream of economics, which has by and large neglected it.

I propose to deal here with a very small portion of Minsky’s written output, the motivation for the selection of which I hope will become clear. Perry Mehrling (1999) has provided us with a complete Minsky bibliography and, more important, a thorough and insightful discussion and analysis of the main body of the published work. Mehrling presents an excellent summary of a theme that permeates all of Minsky’s subsequent work: Minsky was “arguing that attempts to control the money supply by controlling the reserve base were misguided and that the Federal Reserve had better focus on controlling the pattern of interest rates by encouraging use of the discount window and controlling the discount rate. The pattern of his subsequent research can be best understood as an attempt to develop this view, first by deepening his understanding of modern bank operations and,

4. Janet Yellen, in an incisive discussion of the pros and cons of various types and levels of central bank interventions, seems to have ignored what I consider the essence of Minsky’s instability hypothesis, that is, the endogeneity of the sequence of events: “As Minsky’s financial instability hypothesis suggests, when optimism is high and ample funds are available for investment, investors tend to migrate from the safe hedge end of the Minsky spectrum to the risky speculative and Ponzi end” (Yellen 2009, 40). As we shall see below, it is not wholly a matter of being seduced into optimism: Minsky would say, in part, that during the course of an investment boom, the obligations of firms cannot continue to be hedge-financed—there is a debt which must be paid, but the quasi-rents (profits) that are expected to accrue when the investment is completed and begins to pay off are not now available—therefore hedge financing here is impossible and the finance must be at least speculative even if not yet Ponzi.

5. In Minsky (1957, 171) he thanks “the Joint Committee on Education of the American Securities business” for a fellowship.

second, by reformulating it in the terms of modern academic monetary discourse” (Mehrling 1999, 133). In a later work Mehrling presents an incisive summary and account of Minsky’s analysis of financial instability and of his place outside of both “the optimistic Keynesian camp...and the optimistic monetarist camp” (Mehrling 2011, 65-69).

Minsky summarized his own views in the section of his *Stabilizing an Unstable Economy* titled “Economic Theory,” in three densely packed chapters. For him the bottom line is that:

Today’s standard economic theory is largely a creature of the years since World War II. It integrates some aspects of Keynes’s theories with the older classical analysis that he believed he was replacing. This neoclassical synthesis now guides economic policy. (Minsky 2008/1986, 110)

Standard economic theory not only does not lead to an explanation of instability as a system attribute, it really does not recognize that endogenous instability is a problem that a satisfactory theory must explain. (ibid., 109)

Keynes’s investment theory of business cycles and his financial theory of investment in the face of uncertainty were lost as the standard interpretation of Keynes’s *General Theory* evolved into today’s orthodox theory. ... [Keynes’s] understanding into basic relations guiding our economy was reduced by the interpreting economists who followed into a banal set of prescriptions for guiding aggregate output. (ibid., 133)

I have characterized Keynes’ accomplishment as the development of an investment theory of the determination of income and a financial (monetary) theory of investment. (Minsky 1975)

I would note that a similar interpretation of John Maynard Keynes is taken by a few other writers, most notably G. L. S. Shackle (1983). Minsky, incidentally, takes Keynes himself to task for not emphasizing this interpretation sufficiently. Still, Minsky felt that “unreconstructed Keynesianism” is still better than the alternative (1975, 144).

Minsky argued against the convictions of the “policy-advising establishment” that “the credit crunch of 1966, the liquidity squeeze of 1970, the banking crises of 1974–75, the inflationary spiral of 1979–80 and the distress, national and international, of 1981–82 are...aberrations, due to either ‘shocks’ or ‘errors’” and

that “nothing is basically wrong...incisive corrective measures are not needed” (2008/1986, 320). On the contrary:

The major flaw of our type of economy is that it is unstable. This instability is not due to external shocks or to the incompetence or ignorance of policy makers. ... The dynamics of a capitalist economy which has complex, sophisticated, and *evolving* financial structures leads to the development of conditions conducive to incoherence—to run-away inflations or deep depressions. But incoherence need not be fully realized because *institutions and policy can contain the thrust to instability*. We can, so to speak, stabilize instability. (Minsky 2008/1986, 11, my emphasis)

That “institutions and policy can contain the thrust to instability” is the key statement; this theme pervades his work. Previously, he had written that “capitalism is inherently flawed—but financial instability need not lead to a great depression” (1982b, vii). Some of his policy recommendations, as we shall see, are one-time alterations intended to make the economy function better. Other recommendations would require ongoing intervention.⁶

The insistence on the built-in instability of the macroeconomy in the latter half of the twentieth century has led to Minsky being ignored or rejected by mainstream economists. One reason for this, I believe, is a hatred for non-equilibrating systems. Another reason I’ve been given, by one very able, prominent economist, is that mainstream economists haven’t been able to express Minsky’s model/theory/story in mathematical terms.⁷ I have also been told of a perception among influ-

6. I would question the use of the word *stabilizing* in this context, but this raises issues of linguistics, or mechanics, which I do not propose to explore.

7. A number of people on the ‘fringes’, centered at the University of Missouri–Kansas City and at the Levy Institute at Bard College, are working on formalizing Minsky. They seem to be attacking specific aspects of his model/theory, but as far as I can tell, they’ve attracted very little attention from the mainstream of the profession. A very mathematical Australian economist, Steve Keen, has claimed to formalize Minsky’s thesis, and is constructing an elaborate model (for which he appeals to his readers for financial contributions), called “Minsky” ([link](#)). In the latest version I have seen, Keen applies this to parts of *Can “It” Happen Again?*, a collection of Minsky essays; however, the later *Stabilizing an Unstable Economy* represents a fuller, more complete and ‘messier’ model than any essay in that collection. Keen’s models seem much less nuanced than Minsky’s, and I am not aware of his making the broad policy recommendations that Minsky made. However, I am not familiar with all of Keen’s discussions, which appear periodically on his blog ([link](#)). Minsky himself was more than comfortable with mathematics but felt he could not simplify to the extent required. This reminds me of Keynes’s comments on the neglect of the concept of “Effective Demand,” which “could only live on furtively, below the surface, in the underworlds of Karl Marx, Silvio Gesell or Major Douglas” (1936, 32).

ential economists that Minsky offers nothing but a reiteration of Bagehot's knowledge that there are periodic liquidity crises.

The issue of the changing nature and growing instability of the (United States) economy over time is paramount with Minsky. In an earlier work, "Can 'It' Happen Again?" (1982a/1963), Minsky argued that while the deflation of 1933 was triggered by the stock market crash of 1929, the sharp decline in stock prices of 1962 did not similarly lead to a deflationary process. The reason, he argued at some length, is the buffering effect of the larger size of the federal budget: the expenditure by the government and the reduction in tax receipts mitigated to some extent the decline in output, and the increase in the stock of liquid assets due to the resulting federal deficit softened the effect of the decline in liquid assets. We return to this line of thinking in discussing his policy recommendations.

Minsky believed the growing inherent instability of the economy over time is due to changes in the role of money and to the way business is financed. He rejected the concept of money as determinate of the actual and expected price level but divorced from the real economy, as well as the view that the quantity of money is determined exogenously. Minsky saw the quantity of money as endogenous. Banks make loans and then acquire the necessary reserves (Minsky 2008/1986; more on this below).⁸

Money and finance are intimately related, since money is created in the course of activating finance. Finance is required to enable expenditure on investment outlay or consumption, and such expenditure is effected with money. A number of writers, from Bagehot onward (and before), have stressed the importance of finance in development and in economic activity. Minsky was saying more than this. For him, finance is crucial in determining the real equilibrium of a modern capitalist economy.

Minsky found that the economic system is necessarily cyclical. *There is no long-run stable equilibrium.* Or, in the vernacular: Stuff doesn't just happen; it *necessarily* happens. Meanwhile, as he wrote:

In the modern (Friedman, Lucas, etc.) versions of the Quantity Theory monetary variables are allowed into the model, but always in such a way that they can lead only to transitory disturbances of the equilibrium values of variables, but they cannot permanently affect the equilibrium values. (Minsky 1996a, 72)

8. This comes as something of a shock to those who, like me, have drilled hundreds of undergraduate students in the textbook arithmetic of the 'money multiplier.'

In some respects Minsky's analysis is not unlike Hayek's, though their conclusions are 180 degrees apart. For both, endogeneity of money figures importantly, and money matters. But for Hayek it is the *equilibrium* money supply that is endogenous. If I understand Hayek correctly, if individuals and firms could have the quantity of money they wanted, the economy could reach a stable equilibrium. But when he tried to formulate an operating procedure for the authorities to adopt in order to achieve this, he was unable to produce a satisfactory rule. I take this to be the reason why, near the end of his life, he became the leader of the 'free banking' movement.⁹ Essentially, Hayek argued that the problem was the unattainability of the equilibrium money supply, whereas Minsky essentially argued that the actual quantity of money was endogenous both in and out of equilibrium, even in an economy with a government and a central bank.

Minsky 'believed in' the functioning of the market mechanism in the sense that individuals and firms behave rationally; they respond to market signals. He notes more than once that the "neoclassical synthesis" will explain adequately the allocation of goods and factors and the micro equilibrium of a capitalist economy; but such micro explanations do not amount to an explanation of the macro system, including money and banks, a system that is inherently unstable (2008/1986, 112, 114).

[A] capitalist economy is inherently flawed because its investment and financing processes introduce endogenous destabilizing forces. The markets of a capitalist economy are not well suited to accommodate specialized, long-lived, expensive capital assets. ... The activities of Wall Street and the inputs of bankers to production and investment are not integrated into, but are added onto, the basic allocation-oriented theory. (Minsky 2008/1986, 320)

Failure to understand the dissonance between the financial and real sectors, he says, has led policy advisors to miss the main point.

Minsky examines the history of United States banking after WWII (2008/1986, 78-87). At the end of the war, commercial banks held large stocks of government securities, mainly Treasury bills. These could be converted quickly into reserves if the banks needed to close their positions. But by 1974, U.S. government agency obligations were an increasing percentage of government obligations; though secure, "their markets tend to be thin." Furthermore, government obligations constituted a decreasing percentage of total financial assets, from 57% in

9. See Flanders (n.d.) for a survey of Hayek's proposals over time for appropriate monetary rules. An earlier working paper, "Left- and Right-Endogenous Money" (Flanders 2009) might also be of interest since it discusses the differences between the Austrian and the Minskian approaches to money.

1946 to a low of 11.2% in 1974 (*ibid.*, 83-84). In response, the market created other sources of liquidity, from the federal funds market (overnight interbank loans of excess reserves)¹⁰ to Eurodollars (borrowing from foreign branches) to CDs (which required lower reserves). The result was a longer “lag between restrictive actions by the Federal Reserve and a supply response by banks and financial markets” (*ibid.*, 86). He writes:

Policymakers’ impatience to get results will tend to make for serious excesses and overshoots when relations have been loosened. The likelihood that policy action will result in the economy going to the threshold of a financial crisis increases with the number of markets used for position-making, and with the proportion of bank assets bought through the various markets. Thus, as the financial system evolved over the postwar period, the potential for instability of the economy increased. (Minsky 2008/1986, 86)

As the expansion of the 1960s progressed, spending by nonfinancial corporations on physical assets increased rapidly and outpaced the growth of corporate internal sources of funds. (*ibid.*, 98, citing Federal Reserve Flow of Funds Accounts)

At this point Minsky describes, in considerable detail, “The Credit Crunch of 1966” and “The Liquidity Squeeze of 1970” (*ibid.*, 97-105).

Let us take a brief look at some of Minsky’s definitions pertaining to finance. Before introducing the definitions, a few remarks about how Minsky saw things: Banks are typically highly leveraged and by their very nature always borrow shorter than they lend. Most of their indebtedness is sight or very liquid; their lending is always longer, since they finance the operations of firms in their production and sale of goods and services. Nevertheless when loans are directed at wages and salaries and current expenditures, they are repaid as the product is sold. (This is the textbook story.)

Now Minsky uses common terms but defines them explicitly. Bank lending of the longer sort is *hedge* financing. When the economy is going well and expectations are buoyant, firms will borrow—or arrange a line of credit—to finance expenditure on capital equipment. Since the returns to the investment have not begun to flow, the loans may become *speculative*, in that additional borrowing may be needed to cover the current payments due. And if the delay is so great that additional borrowing is required to pay the interest on the loans, the loans are de-

10. This in fact had been developed earlier, in response to higher interest rates, which made it profitable for banks to monitor their excess reserves more carefully as their opportunity cost rose (Minsky 1957).

financed as *Ponzi*. Ponzi finance, not necessarily fraudulent, involves borrowing in order to pay interest and dividends, that is, “the capitalization of interest” (2008/1986, 225 n.7).

At the same time, the profit-seeking drive of the banks and financial innovation may exceed the demand for funds from business for investment, and banks look for other outlets; Minsky says this “can trigger a boom from seemingly stable expansions” (2008/1986, 278). If the boom is in its early stage and interest rates are low, both businesses and banks will be tempted to “not only leverage investment but also to (i) use short rather than long-term debt financing, and (ii) refinance lightly indebted positions in capital assets so as to increase indebtedness” (Minsky 1996a, 83). The system then goes from being “robust” to being “fragile.” These are favorite terms and concepts of his, with “fragile” meaning that small changes cause large responses (*ibid.*).

Furthermore, in the course of a cycle, during an investment boom, costs rise and the costs of continuing an ongoing investment project increase. Aside from those mentioned above, “[e]ndogenous forces make a situation dominated by hedge finance unstable, and endogenous disequilibrating forces will become greater as the weight of speculative and Ponzi finance increases” (Minsky 2008/1986, 238). As wages and costs of materials rise during a boom, the projected profits from an ongoing project decline. If there are delays and bottlenecks, that further reduces the gain to the project upon completion. At the same time, as interest rates rise, the present value of the expected future income, the quasi-rents, from the project declines, and the longer the gestation period of the investment, the more the sunk costs of the project compound. “Interest rates thus enter in both the cost of the project and the value of the capital asset [the present value of expected quasi-rents]” (*ibid.*, 241). The expected income stream from the completed project must be large enough “for its capitalized value to exceed the cost of the completed project, including such interest payments” (*ibid.*). This is true even if the investment is internally financed; if it’s being financed by bank borrowing, this is even more the case.¹¹ “Any transitory tranquility is transformed into an expansion in which the speculative financing of positions and the external financing of investment increase. An investment boom that strips units of liquidity and increases the debt-equity ratios for financial institutions follows” (*ibid.*, 244). All of this entails an erosion of the profit margins and of “the ability to validate the past” (*ibid.*). In sum, “*events that trigger the start of a debt deflation are normal results of the financing relations that lead into and take place during an investment boom*” (*ibid.*, 242, my emphasis).

11. If the project is financed internally, the rise in interest rates during a boom increases the costs of other operations of the firm, so if it was amply financed at its inception, the project is running into a shortage of internal funds.

The fact that investment is financed by debt in the first place, rather than by internal funds, seems to be the root cause of the instability, because the intermediation necessarily becomes increasingly speculative, eventually taking on Ponzi characteristics, as the boom progresses. This is reminiscent of Hayek's insistence that investment has to be equal to (that is, financed by) savings. But then, Minsky is explicit in his statements that capitalism has become more fragile as finance and production have become more integrated.

A brief history of the American economy illustrates the point. Thanks to a "robust financial structure—the legacy of World War II and financial conservatism induced by the Great Depression," the United States enjoyed a period of stability in the 1950s and early 1960s. Things began to change with "profit opportunities open to financial innovators within a given set of institutions and rules; a drive to innovate financing practices by profit-seeking households, businesses, and bankers; and legislative and administrative interventions by governments and central bankers" (Minsky 2008/1986, 219). "The regulated financial structure was... legitimized by the financial debacle of 1929–33, and the deregulation mania occurred in the 1970s and 1980s after a long run without a fully realized debacle." Traditional wisdom was cast aside partly "due to the giant banks' belief that the Treasury, the Federal Reserve, and other government agencies will provide them with a bailout in order to prevent a big crash. The experience of the 1970s and early 1980s validated this belief that the giant financial institutions will be protected" (*ibid.*, 221).

Industrial and industrializing economies need financing not only for commerce and inventories, but also for long-lived capital assets, which were becoming increasingly important by the mid-1980s.

This means that a lack of synchronization between contractual payments on debts and receipts from operations can be built into the banker-business relation as positions in long-lived assets are financed by short-term liabilities.

Capitalism may very well work best when capital assets are cheap and simple. Instability may very well be exacerbated as production becomes more capital intensive and as the relative cost and gestation periods of investment goods increase, for in such a capitalist economy financing arrangements are likely to appear in which debtors pay debts not with cash derived from income production but with cash obtained by issuing debt. (Minsky 2008/1986, 222)

Then, of course, we have a drift to speculative and Ponzi finance. There follows a "taxonomy of cash flows" (*ibid.*, 222ff.) that I have not the space to record, but

which is a detailed description of different types, riskiness, maturities, returns, and, most important, time paths of different capital assets. As noted previously, Minsky was closely familiar with the details of Wall Street of his day.

Minsky's conclusion: "Our economy is unstable because of capitalist finance. If a particular mix of hedge and speculative financing of positions and of internal and external financing of investment rules for a while, then there are, *internal to the economy*, incentives to change the mix" (2008/1986, 244, my emphasis).

My primary reaction to reading *Stabilizing an Unstable Economy* was to wonder how relevant it would be to the present-day economy. Two important changes have occurred: (1) the economy has been dominated by different kinds of firms, and (2) banks are doing different things. The question arises now of how important it is that much firm expenditure today is not for plant and machinery but rather for salaries, etc., for 'development.' A caricature of that is that today we have an economy dominated by Apple, Google, and Microsoft, whereas Minsky in *Stabilizing* is talking about an economy where heavy weight was given to General Motors and U.S. Steel. Second, banks are doing things different from the activities Minsky was describing, which was providing finance to firms for operations and investment. These trends are related, but they are not rigidly tied to one another.

When I looked further into Minsky's later work, I discovered that he had come to discuss at least one of those issues. Since, as noted, Mehrling has surveyed almost all the published work, I have examined some of the very late drafts and notes that were not published, in Levy (and a few Italian) working papers and in drafts of unpublished papers that are to be found in the Levy archives. These continued almost until his death in 1996. Many deal explicitly with the changes in financing and ownership that had taken place in the decade after *Stabilizing*, which he labeled "money market capitalism." Minsky was clearly planning another book.

Prominent among these financial changes is the financing of enterprise by equities rather than by bank loans and the acquisition of equities by funds (pension funds, mutual funds, et al.). In that case the precise nature of production firms (whether they are physical-capital intensive or not) becomes irrelevant. The financing of large and medium firms is no longer carried out through the banks, so the firms are less relevant to the financial system. It's tempting to speculate that the shift from bank to equity finance reflects, at least in part, a growth in the size of the modal firm in the U.S. economy. In any event, the fund managers have taken over. Meanwhile, the banks began to look for other sources of earnings; the proliferation of vehicles for earning interest and betting on appreciation is too well known to require elaboration. In the last decade this was tied in with the boom in housing. One can only speculate whether, had the boom been in some other sector, it would have led to the same outcome; my own guess is that it would have.

I shall concentrate on two of the many drafts in the Minsky archives: a paper on reform or reconstitution of the financial structure, which he presented at a conference in Turkey (Minsky 1992),¹² and that of his planned testimony to the House committee on Glass-Steagall reform or repeal (Minsky 1995).

In the 1992 draft, Minsky begins with a discussion of required changes in financial structure, a major element of which, he argues, is recognition of the fact that “the role of organizations chartered as banks in providing financial services in the United States has been much reduced” (1992, sec. III).

In a brief historical sketch, he notes that the financial linkages connecting the capital assets of the economy and the wealth of households have undergone marked changes over the history of capitalism. There was a progression from “commercial capitalism,” in which banks primarily financed commerce, not production, to “finance capitalism,” which was the era of the big banks and finance houses which imported funds from abroad to build canals and railroads, primarily in the 19th century. The Depression and WWII constituted a hiatus. But

[w]ith recovery the wartime household savings led to a large number of small holdings of stocks. This meant that management of many of the great firms was virtually free of stockholder control. This era can be characterized as managerial capitalism.

In terms of the breadth of ownership of wealth the United States may be called a people’s capitalism. However, over the post war era, aside from the ownership of houses, this people’s capitalism has increasingly become a capitalism of owners of interest in funds. Households own interests in funds, be they pension funds, mutual funds or annuity liabilities of insurance companies. These funds make up a great body of managed money. The managers of this money have a great impact upon what is financed and the way it is financed. This stage of capitalism which is currently in the ascend[ance] can be called money manager capitalism. ...

Much of what has taken place in the financial markets of the United States (and perhaps the world) in the past decades can be explained by the omnivorous demand of these funds for assets, their impetuous pursuit of short term performance and the ingenuity of market operators in developing instruments for such managed portfolios. ...

12. A companion piece about the problems of transition from communism makes fascinating reading, but I shall not discuss it here. These he also labeled as projected chapters for a book.

Systemic over indebtedness may well be a legacy of the emergence of Pension Funds in the United States. Over indebtedness was the initial condition hypothesized by Fisher for the debt deflation process that in his view led into the great depression of the 1930's. (Minsky 1992, sec. III)

Here Minsky refers to “pervasive casino capitalism.”

At the same time, a different phenomenon arose as a result of Paul Volcker's high interest policy, which destroyed the equity of the banks and encouraged them and the savings-and-loan organizations to engage in risky behavior, such as leveraged buyouts. Volcker's policy was part of his successful attempt to combat the inflation and rise in nominal interest rates of previous years. The resulting inflow of financial capital and balance-of-trade deficit hit certain areas (steel, automobiles, inter alia) very hard, as became manifest in the Rust Belt.¹³

As to other trends in bank behavior:

Electronic funds transfers and especially credit cards may well be breaking the hold of commercial banks on the payment mechanism. The main economic innovation of the credit card is the vender's discount...[, which] together with the economies of the electronic based processing systems that have emerged, have created a profit yielding payments mechanism. ...

Banks cannot compete with money market funds unless they first transform the check system into an independent profit center. This will only take place when banks succeed in substituting debit cards for checks, keep a vender's discount on debit card payments and fully price checks... (Minsky 1992, sec. III)

Elsewhere Minsky expresses a favorable view toward such fee-for-service sources of income for the banks, as an accompaniment to the proposals for 100% reserve banking.

Invoking a contrast between Adam Smith and Keynes, Minsky contrasts the invisible hand to inherent instability:

From the Smithian point of view the endogenous generation of debt deflations is a non-starter. Inasmuch as debt deflations and threats of debt deflations (often called systemic instability in today's discourse) do occur, the Smithian program needs to impute these events to

13. My thanks to an anonymous referee for stressing this point.

deviations, however minute, from free markets. Thus deregulation is a preferred policy option.

From the Keynesian point of view the susceptibility of the financial and economic interactions to a debt deflation reflects a transformation of financial structures from being robust to being fragile *as a normal reaction of agents in the economy to the successful operation of the economy.* (Minsky 1992, sec. IV, my emphasis)

Something fairly similar appeared in *Stabilizing an Unstable Economy* and other later papers:

Keynesians and macroeconomists in general need to distinguish between relative price flexibility and price-level flexibility. Relative price flexibility serves a useful purpose in resource allocation, whereas the usefulness of price-level flexibility in response to excess supply of labor is questionable. (Minsky 1996a, 80)

But while price-level flexibility may not eliminate unemployment, the level of money prices does matter:

... in a capitalist economy resource allocation and price determination are integrated with the financing of outputs, positions in capital assets, and the validating liabilities. This means that nominal values (money prices) matter; money is not neutral. (Minsky 2008/1986, 159-160)

I interpret this to mean that *changes* in the level of money prices are not neutral.

A period of success leads to conditions conducive to failure. This process and its effects can be contained by apt interventions, and apt interventions are possible if policymakers, as legislators and administrators, understand the flaws in market mechanisms that lead to the undesired results. In particular, “interventions to prevent or contain the need for units to make positions by selling out positions and devises [*sic*] that sustain aggregate cash flows are needed for capitalist economies to function well” (Minsky 1992, sec. IV).¹⁴ He expresses a concern and caveat:

14. He is concerned, incidentally, about the large part of costs and incomes that are not due to the actual costs of production but rather to the ancillary costs of marketing, advertising, etc. These are included in prices. Casual observation suggests to me that these costs may be even higher today, relative to ‘physical’ costs of production, than they were at the time of writing. However, he expressed concern that the decline in spending as these higher paid recipients consumed less (!) would impose a deflationary bias to the economy. This is one of the few places where Minsky got it wrong; he noted that fact in some of his late writings.

Underlying [any] program of reform lies a model of the model. Unfortunately as the need to reform the financial system is evident, the underlying model maintained by much of the administration, central bankers and even the Congress [!] seems to be Smithian. One bit of evidence which indicates the Smithian bias in the policy establishment is that the discourse is often framed in terms of achieving a financial structure that minimizes the potential “Cost to the tax payer” of sustaining the payments mechanism, rather than in terms of achieving a financial structure that will facilitate doing the capital development well so that the United States can achieve and sustain a close approximation to [a] full employment economy that is also internationally competitive. (Minsky 1992, sec. V)

In 1995 Minsky prepared to testify to the House on repeal or amendment of the Glass-Steagall Act (Minsky 1995).¹⁵ As I read it, he hadn’t really made up his mind whether it was a good idea or not to repeal Glass-Steagall: would it make a difference? It seems he was uncertain, nor was he alone in that. Nevertheless, his discussion of the issues is both interesting and incisive. It gives us some insight into an understanding of what he was predicting with respect to the future path of banking, at any rate in the United States.

In a brief survey of the history of U.S. banking from 1788 to the present, he notes that the Glass-Steagall Act separated commercial banks (specializing in commercial, self-liquidating loans) from investment banking on the grounds that supervisors would more easily understand the ‘routine’ operations of the former, whereas the investment banks were supposed to be innovative and hence more difficult to supervise.

The insurance schemes that were established as part of the legislation were not needed until the 1980s, at which time there were commercial bank failures, which the FDIC was able to cover, and S&L failures, which the insuring agency could not cover and that required rescuing by the federal government. The insurance agencies weren’t looking when the S&Ls and banks went into construction and land development, which they weren’t supposed to—their legitimate territory was solely the financing of home loans. But the very high interest rates of the late 1970s and 1980s destroyed the net worth of the S&Ls,¹⁶ so the supervisors let them venture into new areas, such as construction and, land development, and,

15. The bill was finally repealed by the Gramm-Leach-Bliley Act in 1999. The jury seems to be still out as to whether or not the repeal was either necessary or effective and specifically whether the repeal contributed to the events of 2007–2008.

16. References to the destruction of bank net worth by high interest rates arise frequently in Minsky’s discourse. It reminds us again that he served as a director of a bank for 30 years.

notoriously, acquisition of junk bonds.¹⁷ From the vantage point of 2014 this raises the issue of the possible disjunction between the legal and institutional/legislative framework and the actual sophistication or vigilance or dedication of the supervisory and enforcement agencies.

Minsky felt that, with modern electronics, telephone banking, and the ATM, “the monopoly power due to location, which was important when the Glass-Steagall Act was passed, has been much diminished” (1995, 7). (Today, of course, this is even more the case, with online banking.) Now, he argued,

...banks are special only because their liabilities serve as part of the money supply. It is still believed that any serious disruption of the ability of banks to meet their commitments on that part of their liability structure that is part of the money supply would lead to serious disruptions of the economy. The model of the economy that underlies the treatment of banks as something special, both in their chartering and in the government’s protection of the value of their deposit liabilities, needs to lead to propositions which assert that if some banks fail and their deposit liability holders are not “made whole” by government intervention then a serious depression is likely to occur. In other words financial instability, such as we experienced between 1929 and 1933, is a necessary and perhaps even a necessary and sufficient condition for a great depression... (Minsky 1995, 8-9)

At the time Glass-Steagall was passed, banks served a number of purposes: giving information to other banks about local business, vetting business propositions and profitability, estate management, and so on. Now, he says, these functions are not needed and are provided by other institutions. (However, later in the document he seems to contradict this.) The only really necessary function of a bank is to provide legal money. In this case there is something to be said for 100% reserve money. It was worth considering the advocacy of Henry Simons and Irving Fisher for 100% money, the idea being that capital development and the creation of money should be separated.¹⁸ There is a slight disjunction here, since at one point he noted the function of the bank in advising and financing small businesses, executing wills, and similar activities.

17. The entry of S&Ls and banks into real estate was also encouraged by the drying up of the traditional channels for bank lending that accompanied the development of fund ownership and equity financing of firms.

18. In the wake of the recent J. P. Morgan escapade, the notion of separating money creation from the supply of finance seems increasingly attractive.

Minsky's testimony proceeds to a detailed exploration of the possible/probable outcome of repeal: universal bank holding companies, which hold different kinds of financial companies or institutions, each with its own capital position, riskiness of assets, and type of activity. Presumably these are to be isolated from one another. In hindsight, I suggest that he did not accurately predict the permeability of the walls between these 'separate' banking departments. Perhaps the following shows where he went wrong:

Every universal bank will need to set a precise limit to the equity it allocates to merchant banking activities. Given the size of the possible capital losses and gains in such merchant banking, some means of "insulating" commercial banking activities from merchant banking activities of conglomerate organizations chartered as universal banks will be necessary. ...

The development of what can best be called money manager capitalism, in which mutual and pension funds are the dominant proximate "owners" of the equity and debt liabilities of corporations[,] is a major change in financial arrangements since the 1930's reconstruction of the financial system. These mutual and pension funds presumably act for the benefit of the households who are the ultimate owners of the assets these organizations have in portfolio: they stand in a fiduciary relation with the owners of their liabilities.

There is ample evidence that the ethics that guides many operators in the financial services industry, including some in our most prestigious outfits, is summarized by a remark cited in *The Economist* in April 1994: "If God had not meant them to be sheared, He would not have made them sheep" [Hodgson 1994]. ...

Given the evolution of institutions over the past decades I would like to suggest that those institutions which manage money and are in a fiduciary relation with households be separated from institutions whose primary focus is upon trading and investing for the benefit of the owners of the firm's capital and their staff whose compensation is based upon performance. Universality may well exclude pension and mutual funds.

Thus even as the wall between investment and commercial banking that found expression in the Glass Steagall separation in the 1930's we may need a new separatism as the 21st century approaches, one that separates investment banking and the managing of mutual and pension funds. Managers of mutual and pension funds are presumably in a fiduciary relation with the owners of positions in the

funds. The personnel of a broad post Glass Steagall “Bank” are guided by profit maximizing and own income. The fiduciary and the merchant banker-trader are different personality types and have quite different objectives. Thus a Bank holding company may well be forced to choose between having an investment bank or a mutually [*sic*] fund management affiliate.

A possible adverse effect of universal banking is that the number of independent banking institutions will decline even as their equity bases are likely to increase. The natural financing habitat of a banking institution is given by its capital accounts and a prudential limit on its exposure to any one account. This natural habitat will increase as the consolidation of banking into fewer but larger institutions takes place. This evolution would leave unsatisfied pockets of potential bank clients. Any formal move towards universal banking will need to meet such unsatisfied fringes by allowing entry into banking to be relatively unrestricted.

The elimination of Glass Steagall does not guarantee that either the safety and security of the payment mechanism will improve or that the financing of the capital development of the economy will be done any better than under the old regime. Perhaps it is of greater importance to think through how the emergence of the new dominant player in finance, the pension and mutual funds, affects the capital development of the economy. (Minsky 1995, 19-22, my emphasis)

In sum, Minsky (1995) saw issues and problems ahead, and he hadn’t worked out how they would—or should—be handled. I venture to suggest, however, that despite the very sophisticated understanding of the financial establishment that he possessed, he like many others underestimated the aggressiveness, ingenuity, and sheep-shearing abilities of a number of agents in the financial sector in the decade after his death, as well as the failure, or absence, of oversight and the lack of insistence on the separation of functions, which he had advocated and perhaps taken for granted. However, Minsky was confident of the ability of the authorities to handle any problem, if the will existed.

[The] assurance that cash flows will be sustaining is provided by the combination of a fiscally prudent big government, which by its deficits can sustain profits, wages and government tax receipts, and central bank lender of last resort operations, which in the modern world not only support liquidity but also the equity base of institutions whose failure, it is felt, may trigger systemic instability. (Minsky 1992, sec. III)

That is, ‘too big to fail.’

In 1996 Minsky was granted the Veblen-Commons Award, given by the Association for Evolutionary Economics. His speech for the award ceremony was, to the best of my knowledge, his last publication (Minsky 1996b). Here he reaffirms his long-standing identification as an institutionalist and notes that Keynes evidently was one, as well. I suggest that this publication shows us the way Minsky was going at the time of his death. He starts with a summary of what is to follow; a summary of his summary follows here.

Minsky (1996b) welcomed Thomas Sargent’s *Bounded Rationality in Macroeconomics* (1993) as a recognition of the importance, stressed by Keynes, of uncertainty (as distinguished from risk) in economics. Its incorporation in economics was, however, incomplete, he asserts, because the New Classical economists continued to restrict their analysis to the real sector. Minsky (1996b) throughout is concerned with the inclusion of money in the model and its (money’s) endogeneity:

Keynes aimed to develop a theory of an economy in which, because of its structure, money cannot be neutral. He achieved this by dividing prices into those which are dominated by the need to recover costs and those which are determined by the value placed upon future income flows. The former consisted of the current outputs of current consumption and investment goods, and the latter consisted of the prices of the outstanding financial and capital assets.

The bounded rationality approach retains the assumption that preference systems are over the reals and that outputs and relative prices can be determined independently of monetary and financial variables. The impact of nominal values and financial relations are only of transitory significance. ...

A premise of Keynesian modelling is that the capitalist economy cannot be understood by splitting it into a real and a financial or monetary sector. Keynesian modelling holds that a basic aspect of the structure of capitalist economies is given by interrelated balance sheets, income statements, and the time series of cash flow commitments that are embodied in financial instruments. (Minsky 1996b, 361)

We see that Minsky’s theme of the non-separability of the money and the real sectors of the contemporary capitalist economy has remained through the decades.

Minsky emphasizes the significance of the new stage of American capitalism, “money manager capitalism,” which he had discussed and explored in earlier papers.

The total return on the portfolio is the only criteria [*sic*] used for judging the performance of the managers of these funds, which translates into an emphasis upon the bottom line in the management of business organizations. It makes the long view a luxury that only companies that are essentially owned by a single individual and that are not deeply dependent upon external financing can afford. (Minsky 1996b, 358-359)

Capitalism is different in different countries.

For the United States, the financial stages of American capitalism can be characterized as: commercial capitalism; industrial capitalism and wild cat financing; financial capitalism and state financing; paternalistic, managerial, and welfare state capitalism; money manager capitalism. ...

[T]he evolution has been from a financial structure where external finance was mainly used for trade to a structure where there is ever greater use of external funds to finance the long-term capital development of the economy. (Minsky 1996b, 362)

The public dislikes uncertainty. In its time, Minsky says, the New Deal reduced uncertainty. For example, agricultural price supports in the New Deal promoted the mechanization of agriculture and a huge productivity increase. But “[t]he evolution of the economy has decreased the effectiveness of the New Deal reforms, and money manager capitalism has radically increased uncertainty” (Minsky 1996b, 359). What is required is big, and presumably variable, government. New institutions are required to limit the effects of uncertainty. “The success of business in the era after World War II was assured by rigging the game in favor of business profits” (*ibid.*, 364). This advantage too has been eroded in recent decades. “For a modern capitalist economy to be able to avoid debt deflations, and therefore great depressions, governments need to be able to run deficits when the incentive to invest by the business sector is compromised” (*ibid.*).

He concludes with an inventory of measures which will reduce “the insecurity bred by the attenuation of the effectiveness of the New Deal structures along with the heightened uncertainty due to money manager capitalism” (Minsky 1996b, 359). He is concerned about the size of the federal deficit and recommends a reform in the tax structure designed to lessen it. At the same time, he advocates a large Federal sector, so that there will be ability to vary this as needed in response to private sector fluctuations. He refers to the need for rethinking the system of intervention in capitalist economies that evolved out of the New Deal. In

particular, there is a need to make full employment the main goal of economic policy. “A full employment economy is supportive of democracy whereas an economy based on transfer payments supports resentment” (ibid., 367). (On that one, perhaps, the Tea Party might agree with him.) Furthermore, a large government budget allows provision of public goods, which promote social stability. “Wide disparities in personal incomes and wealth are compatible with a well-functioning society, as long as ambience, health care, and education incomes are available and open to all” (ibid., 365).

The policy recommendations are similar to those which constitute chapter 13 in *Stabilizing*, but an additional one mentioned there is noteworthy: to eliminate the corporate income tax. “A corporate income tax...induces debt-financing and is therefore undesirable. A corporate income tax also allows nonproduction expenses such as advertising, marketing, and the pleasure of the executive suites to be charged against revenues in determining taxable income” (Minsky 2008/1986, 340). When Minsky wrote this, U.S. corporate profit tax rates were of the same order of magnitude as those of the rest of the OECD countries. Since then, most of the others have been halved, leaving the U.S. with rates roughly twice that of most of the rest of the world. The incentive to switch corporate registration abroad to avoid these taxes has been widely discussed by both ‘right’ and ‘left.’

What would Minsky have said about the events of 2007 and after? I expect that it would be as different from what he said in 1996 as the latter was from the analysis of 1986. His basic epistemological, theoretical, and political position remained unchanged over the years. The specifics of the analysis and policy recommendations were adapted to the changing facts on the ground. Today I suppose that he would emphasize that the government should be an employer of last resort, especially in relation to young people, and I think he would tie this in with infrastructure development—replacement and addition. More than that, I do not have the chutzpah to guess.

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