JAN KREGEL

"Minsky Meets the Mediterranean"

Abstract. Does the experience of Greece since its entry into the eurozone conform to Hyman Minsky's analysis of financial fragility? Examination of the major macroeconomic variables over the period suggest sustained, if not rapid, expansion, with stable inflation as well as internal and external accounts. The period would thus seem to conform to an evolution of the economy that might generate a declining cushion of safety in the decisions taken by financial institutions and governments that created increasing financial fragility. In Minsky's original formulation, fragility could be transformed into systemic instability as the result of a policy shock such as a tightening of monetary policy that causes interest rates to rise and speculative positions to become compromised. In the case of Greece, the trigger was the announcement of the revised figures for the fiscal deficit, which produced a threefold increase in interest rates in the first six months of 2010. The declining cushion of safety can be identified in two areas. First, under the conditions of the euro, government debt is no longer sovereign, and its creditworthiness is determined by the government's fiscal position. The revised statistics were thus the equivalent to an announcement that the debt represented Ponzi rather than speculative financing positions. The hidden government deficit was thus a de facto reduction in the cushion of safety on government paper. The second area is in the behavior of the European financial institutions that invested in Greek paper, since it carried a zero risk weight under Basel rules and a small interest arbitrage gain. Thus, the action of foreign banks to drive Greek yields to increasing small spreads against German debt also represents a decline in the cushion of safety in the positions of these institutions that was insufficient to cover losses once the new fiscal position was announced. The result was a traditional Minsky–Fisher debt deflation process in which financial institutions sold position to make position, which further accelerated the decline in prices.

The denouement of this process did not, however, conform to the traditional Minsky scenario, which would have required the action of a central bank lender of last resort to stabilize asset prices, government stimulus to support domestic incomes, and the write-off of some of the existing debt. Initially, none of these responses were present, and were only subsequently applied with reticence. More markedly, instead of supporting domestic incomes to create greater government revenues to service debt, the provision of support for asset prices was provided only on the condition of fiscal austerity measures that increased the Ponzi nature of government debt. In contrast to the crisis response in Latin America in the late 1980s and Korea in the 1990s, the required fiscal measures were made more draconian rather than more supportive of domestic growth, leading to the position that Greek government debt will never be repaid, and the only policy question remaining is how European Union (EU) taxpayers will be told that they will be responsible for the write-down of the official EU and European Central Bank support.