HYMAN MINSKY CONFERENCE (Berlin)
INTRODUCTORY REMARKS (11/26, 27/12)
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I want to welcome you to this Hyman Minsky Conference jointly sponsored by the Levy Economics Institute of Bard College in New York and ECLA of Bard, here, in Berlin.

I also want to publicly thank the Ford Foundation and especially Program Officer Leonardo Burlamaqui not only for making available the financial resources to organize this conference, but also for his incisive guidance to the Institute's program on Financial Instability and the Reregulation of Financial Institutions and Markets.

Many thanks are also due to the German Marshall Fund of the United States for their invaluable assistance, and the Deutsche Bank for hosting the conference in this attractive meeting room.

The conference is an outcome of the Institute's research program on Monetary Policy and Financial structure headed by the Institute's long-time senior scholar Jan Kregel. Jan inherited this research endeavor from the late Hyman Minsky, a maverick economist, who initiated it when he joined the Institute in 1990 and whose prescient contributions to economics have finally been recognized not only in the United States and Europe, but also all over the World.

I do not know how much you know of the Levy Economics Institute, located on the other side of the Atlantic or of ECLA of Bard, the Liberal Arts University here in Berlin.

I hope you will allow me to say a few words of propaganda for both institutions.

The Levy Institute was established in 1986 as a unit of Bard College. It is independent, nonprofit, nonpartisan public policy research organization that encourages a diversity of opinion in the examination of economic issues profoundly affecting the United States and the rest of the world.
We are concerned with financial instability, the capital development of the economy, unemployment, the purchasing power of workers, the distribution of income, wealth and well being, and gender equality.

Our main purpose is to generate viable, effective public policy responses to pressing economic problems. We disseminate information, facilitate interactions (such as this conference) among academics, business leaders and policy makers, and we do public outreach.

ECLA of Bard is the Liberal Arts University in Berlin. It is a small University approved by the Berlin Senate, and our plans are to grow larger by adding more undergraduate and graduate degree programs as well. ECLA has been in existence for about 10 years, and since a year ago it became a unit of Bard College.

It seems that ECLA has been a secret in the wider Berlin community. We are, however, hard at work to change this and make it known not only in Berlin, but also throughout Germany and elsewhere.

Words of propaganda are usually accompanied with printed material, and we invite you to take a look at the various brochures we have at the registration table. There you will find Institute papers relevant to the topics of this conference.

And, there are members of the Administration of ECLA, including Thomas Rommel the Rector and Provost, who can answer questions about the University's programs, admission policies, and provide other information.

As it was indicated, this conference is one of the public outreach activities of the joint Ford-Levy Institute project undertaken to investigate the root causes of the last financial crisis drawing from Minsky's extensive work on the structure of financial systems.

Its focus is the assessment of the various financial reform initiatives, such as the Dodd-Frank Act in the United States, and other reform attempts in the European Union, Great Britain and Latin America.
The project seeks to determine whether the new regulatory structures, once they are put in place will prevent a debt deflation and a systemic crisis from happening again. The guiding question is to what extent financial reform legislation and proposals will be capable in identifying and responding to what Minsky showed to be an inherent generation of financial instability.

From the point of view of Minsky's analysis a process of increasing financial instability comes about when the ability of debtors in the private sector and the public sector –especially those lacking currency sovereignty—to generate private profit or fiscal surplus, is continuously worsened.

In Minsky's terms these debtors' profiles, then, transition from hedge to speculative to Ponzi or Madoff finance. Of course, everyone has heard of Mr. Madoff, the swindler

The theme of this conference is "Debt, Deficits and Unstable Markets." We are, at present, confronted with a stock of private sector debt that remains high despite the ongoing deleveraging process from the borrowing frenzy—a

frenzy of high mortgages for what many assumed to be infinitely increasing housing markets in the U.S., Spain, Ireland, Portugal, even the Netherlands, starting almost a decade ago, and gone bust in 2007-8.

On the public finance side, many countries are running high deficits and increasing debts. The Eurozone sovereign debt crisis is of special note, starting in 2009 with the inability of Greece to roll over maturing public debt.

High deficits, debts, together with bad policy have created unstable markets. The ineffective and disastrous austerity policy responses miscalculating fiscal multipliers have made matters worse delivering unprecedented high unemployment rates, deep recessions, along with increasing levels of inequality, poverty, despair and ironically even higher debt.

Euphoric periods with accommodative monetary and/or fiscal policy stances help increase both the government and private sectors' borrowing and debt, linked to the deterioration in the balance of payments. Indeed, there is a macroeconomic identity that connects the internal (public and private sectors) and external (current account) balances, and although this identity is not a theory, it informs policy.

Using this macro identity, the trajectory of any economy can be predicted. For instance, in late 2006, Levy Institute reports by the late Wynne Godley and others warned of the US' forthcoming recession. In 2007, the prediction came to pass.

On this side of the Atlantic, the introduction of the euro was based on member countries' convergence of domestic inflation represented by an inflation target, a government deficit and debt to GDP ratios, paying no attention to the widely different domestic economic and monetary conditions across countries.

Even though convergence of the monetary variables was achieved, it came with increasing divergence of real economic performance, for example, in productivity, labor costs and real rates of return across member countries. And this divergence surfaced as intraregional trade imbalances financed by increasing cross border lending within the Eurozone.

Furthermore, because of inflation and interest rates convergence, financial institutions did not recognize risk differentials across the member states. The relative risks of individual countries issuing sovereign debt that should have been dependent on the real economy of each country vanished.

Ultimately, this meant that the ability to repay debt became more and more dependent on the ability to borrow to meet interest and principal payments. Minsky, had he been alive, would have called it a Ponzi scheme.

As lenders came to recognize the inability of the borrower to service (validate) debts, they withdrew support, and financial instability became a financial (sovereign debt) crisis.

Many scholars from the Levy Institute had suggested policy changes then, as they are also suggesting now dealing with the US and the Eurozone. Our recent research finds that in the US, for example, despite the modest improvements in the employment rate, the present rate of job creation is still insufficient to recoup the employment lost since the recession began or to provide enough jobs for the average monthly number of new entrants into the labor force.

At the current pace, it would take more than 120 months to reach full employment. Hence, achieving a big improvement in the labor market will require much higher growth rates than those the economy is presently experiencing, and this can only come from increasing private and/or public sector demand.

Alternative options to achieve higher growth rates different from those assumed by the executive and legislative branches of government are available.

The plausible options are: either resuming private sector borrowing in amounts that are large enough that they will most likely result in another Minsky crisis and a significant risk to the country's still shaky financial system, or more realistically, a public spending plan that includes the renovation of the country's tax structure.

The scenario to be avoided is, naturally, the "fiscal cliff" scenario that will throw the US and the global economy into a new and deeper crisis. I won't go into the details of these policy options, but I ask you to visit the Levy Institute's website if you are interested for more information.

As Minsky pointed out, in a modern, complex economy, investment depends on financing conditions in accord with the current views, held by the representatives of business and banking communities, of future cash flows.

The economy can be distinguished by expectations of cash flows and realizations by the business community that use private capital assets and need to fulfill contractual payment commitments.

Both capital and financing structures are dependent on the past, the present and the future. Expectations and the consequent behavior are dependent on the economic model used: for instance, a model that assumes that economies like the US and Europe are normally successful will produce different

behaviors compared to a model that assumes that what happened during the Great Depression or the 2007-2009 Great Recession were normal, albeit rare events that could happen again, if the same circumstances were repeated.

Uncertainty in the minds of agents makes it difficult as to which of the two models is relevant in forming expectations, especially, if many years have gone by since the last financial crisis associated with a significant economic correction.

Memories are erased quickly and evolutionary changes, whether legislated, administered, or both, transform the economy's institutional structure. The past becomes less of a guide to the behavior of markets and agents, especially in a world where a Big Bank (central bank) intervenes to contain financial crises.

Minsky recognized the need for a financial structure that will always need be in concert with the evolutionary nature of financial innovation.

In 1989, Minsky wrote that the trajectory an economy follows through time depends upon the interactions between endogenous dynamics that will not necessarily determine a satisfactory path for the economy; nor will the constraints and interventions that make up the structure of regulation produce tolerable or satisfactory outcomes.

Over the longer run, the satisfactory performance of a capitalist economy depends upon the aptness of the structure of regulation. Profit-seeking agents learn how a regulatory structure operates, and since regulation means that some perceived profit opportunities are not open to exploitation, there are incentives for agents to change their behavior to evade or avoid the imposed constraints.

This implies that over time, the consequences of a structure and organization of intervention change. Interventions that start out being constructive can be transformed into sources of instability and inefficiency.

The debacle of securitization of mortgage-backed securities together with the slicing, and dicing of securities and the over-layering of derivative instruments, demonstrate that a structure of regulation and intervention that is initially successful can become perverse.

The experience with mortgage-backed securities, the assortment of off-balance sheet special purpose vehicles, credit default swaps and the humongous size of shadow banking (reported recently to be in the order of $67 trillion) is certainly not an argument for laissez-faire, but rather an argument that intervention cannot be frozen in time.

It must adapt to evolutionary changes in institutions and usages. Successful capitalism requires both a structure of regulation and a sophisticated awareness of the way profit- seeking activities drive the changing of business and behavior.

Washington's response to the financial and economic crisis placed the government's full faith and credit on the line, became the subject of strong legislative debate, and changed the mood and makeup of Congress.

We saw, that as financial and economic uncertainties became more evident, the policy agenda turned to the creation of a financial structure that supposedly would be less subject to excesses of speculation and would promote the capital development of the economy. But it is doubtful that the Dodd-Frank Wall Street Reform and Consumer Protection Act will ensure control over speculation or ensure the support of enterprise.

So what do we do to establish a more stable financial system? Minsky had developed a set of ideas, a blueprint if you will, to reconstitute the financial structure. The Ford Foundation-Levy Institute project concentrates on these very Minskyan ideas and has published a series of papers drawing from Minsky's published and unpublished works. Again, we want to bring to your attention the Institute's publications that you will find displayed on the table in the back. We invite your close scrutiny of it and will welcome your comments.

Thank you very much for coming and enjoy the conference.