MINSKY SUMMER SEMINAR (June 2010)

INTRODUCTORY REMARKS TO ACCOMPANY POWER POINT: LEVY INSTITUTE AND HYMAN MINSKY

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- ***Levy Institute***

How did the Institute come about? Why here? What was the role of the Levy family?

Jerome Levy (who was he?); similarities with Kalecki --Jerome Levy, a businessman, was naturally interested in profits. He wrote an incomprehensible book *"ECONOMICS IS AN EXACT SCIENCE*" of about 500 pages back in 1943. Minsky started reading it and gave up and so did many other people including members of his family. But I read it. All in all, what one gets from Levy's book and other notes is the

- ***Profits Equation*** that will be explained among other things by Jan Toporowski in his lecture tomorrow.
- Minsky too was influenced by Kalecki.

- ***What drives the Levy Institute's mission?***

The research areas –monetary policy and financial structure, unemployment and inflation, distribution of income, that are the focus of the Institute's programs bear many Minskyan stripes. To be sure Minsky, as far as I know, neither wrote nor said anything about gender equality. Our interest in this area, however, stems from our work on examining economic well-being. A group of scholars has developed a measure of economic well-being (LIMEW) encompassing four measurement components: Money income, wealth, government production and home production. The last component includes paid and unpaid production distributed along gender lines. Gainful employment becomes a very important aspect of gender equality as it will be shown in the lectures of Rania Antonopoulos and Pavlina Tcherneva.

***HOW DID MINSKY GET INVOLVED WITH THE INSTITUTE*?**

- ***Minsky and the Levy Institute***

Personal reminisces –Trieste School (started in 1981--reference to Jan Kregel-- met Minsky through Tom Asimakopulos and Steve Rousseas)

- When Minsky joined the Institute the world was still trying to figure out the reasons of the stock market crashes of 1987 and 1989, the debacle of the savings and loan associations and the FSLIC, the continuing problem of Latin American debts, and the unraveling of the junk bond market. (Citibank then was also broke with its common share traded at a very low level –even though it never reached 90 cents as in this crisis. In the late 1980s, a wealthy Prince rescued it while in this crisis by the US treasury and the Federal Reserve did it.)

- ***Minsky and the Levy Institute relation***

Minsky joins the Institute in 1986 as advisor and then distinguished scholar until his death 1996.
Importance of WALL STREET IN ECONOMICS with progressively higher forms of speculation caused by increasing leverage ratios. --Hedge, Speculative and Ponzi investment profiles. Leon Levy having spent a nice sum supporting the Brookings Institution became interested.

SOME MINSKY BIOGRAPHICAL MUSINGS

- ***Who was Minsky and what do we know about him?***
- Born in Chicago (23 Sept) 1919. His father Sam emigrated from Russia after the failed revolution in 1905. His mother (Dora Zakon) was active in the Trade Union movement and met Sam at a celebratory event of the Socialist Party in Chicago marking the 100th anniversary of Karl Marx. Attended schools in Lima, Ohio; Chicago, and New York City. He went to the University of Chicago in 1937 when the University was sane, and was influence by the teachings and writings of the radical Oskar Lange, the liberal Paul Douglas, the middle-of-the-road Jacob Viner, and the conservatives Frank Knight and Henry Simons. He first started concentrating in mathematics, but was pulled away from it to economics, especially, from the lectures of Oscar Lange, Maynard Krueger and Henry Simons, and the many conversations with Gerhard Meyer (whose library is housed at the Levy Institute). He also developed other friendships including the long-lasting one with Abba Lerner –whose many contributions includes the concept and theory of "***functional finance"***. You will hear these names and concepts many times during the course of this seminar.
- Encouraged by Lange, after graduating from Chicago in 1941, he joined Leontief's group at Harvard that was developing the input-output construct. Lange apparently thought that the input-output scheme was an important tool for planning in the socialist world. During the time at Harvard, he met Jim Tobin, Bob Solow, Evsey Domar, and Andreas Papandreou.
- Minsky still wanted to return to Chicago but Leontief made him an offer he could not refuse –a much, much bigger fellowship. And so he began his graduate study at Harvard that was interrupted by his induction into the US Army. He was first stationed in New York and eventually was sent to Europe with successive assignments, in England which included a very important one not only because he escorted an important shipment, ***of nylons*** for the Women Army Corps to a place near Cambridge, but because he met the important economic figures of that time Joan Robinson, Richard Kahn and Piero Sraffa. Next stop was Paris and Frankfurt, and eventually Berlin working in the Manpower Division of the Military Government until 1946.
- Returning home, his decision to resume graduate studies at Harvard was not financial, since Chicago had made him an even better offer from the one at

Harvard, but because most of his Chicago mentors –Lange, Simons, Viner and Douglas would not be there. John Henry's lecture tomorrow will delve deeper of their influence on Minsky's intellectual development.

- Harvard for Minsky was not as intellectually intense an environment as Chicago in that the approach to teaching was rather mechanistic. At Harvard he came to know Joseph Schumpeter who became his doctoral dissertation adviser. Three years later in 1949, he left Harvard to begin the professorial career at Brown University. In the meantime Schumpeter died and Hy Minsky finished his dissertation in 1954 under the supervision of Leontief even though the topic of "Induced Investment and Business Cycles" was very far from Leontief's interests.
- Minsky's dissertation explored the relationships between market structure, the financing constraints of investment, survival of firms, aggregate demand and business cycle performance. The dissertation formed the basis of the subsequent development of financial Keynesianism and the Wall Street Paradigm for which he is well known. Uncertainty, the coexistence of other market structures and the behavior of the financial system played an important role in it.
- Once tenured at Brown, he accepted an offer from Andreas Papandreou to join the economics department at Berkeley in 1957 and stayed there until 1965 when he moved to Washington University in St-Louis until his retirement in 1990, when he officially joined the Institute as Distinguished Scholar. A year's sabbatical brought him back to Cambridge in the UK where he first met Jan Kregel, and renewed his acquaintance with Joan Robinson from whom he learnt a lot, but who was often "*wrong especially in incisive ways*."
- At Berkeley, he developed his ideas and theories fully, about financial innovation and the importance of the initial condition of financial positions that would determine the future of the economy.
- Minsky argued that robust corporate balance sheets over time would become fragile, resulting in economic conditions that might deflate debt, --these instances we call them now as ***Minsky Moments*** —leading to a repeat of the 1930s and to the current Great Recession. This involves none other than the progressive state of financing profiles from ***hedge*** to ***speculative*** to ***Ponzi***. You will hear these concepts laid out in considerable details from the speakers that follow in this seminar.
- In conversations with Minsky, it was clear that while his last book on ***Stabilizing an Unstable Economy*** took the same fundamental structure of his first book ***John Maynard Keynes,*** it treated it not as a history of doctrine, but as a positive theory. In Minsky's own words, the first book offered "an alternative interpretation of Keynes –one which builds upon those aspects of The General Theory that emphasize investment in a world where business cycles exist and engender uncertainty. This leads to a quite different image of how the world operates than that embodied in current standard theory." The second book, he contended on many occasions, was not an interpretation of Keynes alone. It followed Kalecki in linking profit flows to investment. Profits become both the lure of new investment and the result of realized investment. Central bank

structure and the way it functions when the banking sector is disrupted lies at the core of his book along with the role of government.

- Minsky had spent sufficient time analyzing the conditions of the Great Breakdown of 1929-33 (as he preferred to call the Great Depression) and recognized the similarities in Levy and Kalecki since the Levy-Kalecki relations show that massive government deficits lead to a large-scale business profits.

PROFIT EQUATION SLIDE

- Unlike the orthodox view arguing that both the mass and distribution of profits are determined by the technical condition of production and market structure, the Levy-Keynes-Kalecki and Minsky view that macroeconomic relations determine aggregate profits and that market power and the technical conditions of production determine the distribution of profits is fundamentally different. (Again Jan Toporowski will develop the detailed relationships tomorrow.) Suffice it to say that in this alternative view, stabilization policy will be effective as long as both realized profits and expectations of the future flow of profits are stabilized.
- In an economy as ours profit expectations are stabilized by policy measures that operate upon the inducements to invest and the financing of investment, the government deficit, the propensities to consume and the foreign trade balance. This leads to the relationship of the macroecomic accounting identity to which I will return later.
- If the economy's structural relations, such as the government commitments to spend, the tax code and the size of the government make the government deficit move quickly and strongly in the opposite direction from investment, then both realized and expected profits will be stabilized. ***This is the none other than the Minskyan case of BIG GOVERNMENT.*** (More on this concept of big government from Eric Tymoigne on Thursday.)
- The financing of investment and the financing positions in capital assets, a profit-oriented analysis of capitalist economies leads to the importance of institutions with which business interacts as it seeks financing. In determining an economy's path, it is crucially important to know, the flows of payments from debtors to fulfill financial commitments and the flows of funds from financial institutions to investing units. A systemic shortfall of profits diminishes new financing for investment that together with shortfalls of cash to validate debts has far reaching repercussions, ultimately leading to a debt deflation. Sophisticated economies have developed formal institutions, that is central banks that will attempt to contain or abort debt deflation. (Again Eric will develop the concept of ***BIG BANK*** on Thursday.)
- These ideas endeared Minsky to Leon Levy and other members of the Levy family.

MINSKY WHILE AT THE LEVY INSTITUTE

- During his time at the Institute, he established the research program of "Reconstituting the Financial Structure" in response to US legislative and White

House activities to unravel the established structure of financial regulation and supervision and to eliminate the legislative enactments of the New Deal Era. He was deeply concerned with the safety and soundness of the payments system especially with the rapid evolution of capitalist financial markets and usages and the decline of traditional banking. His concerns extended to the international dimensions of finance and the problems of the construction of a capitalist financial system *de novo* in the former communist countries. He was disturbed by the increasing debt levels and greater leveraging and had predicted (1987) the explosion of securitization and the likely consequences that we are enduring currently.

- He organized and launched, in 1991, our annual conference on ***Financial Structure and the State of the US Economy*** to bring academics, central banker and other policy makers and individuals from the banking community. This conference continues and last April we held the 19th Conference. It has now become an event populated by Federal Reserve Governors and Presidents, academics and bankers.
- He directed the Institute's effort ***to kill the proposed Balanced Budget Amendment***, working patiently in drafting various statements for the press and legislators with the neoclassical members of our then Advisory Board, i.e., Franco Modigliani, Jim Tobin and Henry Rosowski that took place during Newt Gingrich's reign in the US Congress and his ill-conceived contract ***WITH*** America that was more a contract ***ON*** America.
- Minsky is well known for the development of the ***financial instability hypothesis***, which leads to ***a two price-level view of capitalism***. One price level, that of current outputs, rests upon the costs of production as mainly determined by the wage rate and mark-ups which represent market power, the second price level, that of capital assets, mainly rests upon the present valuation of expected future income streams, carrying costs and the liquidity of different assets–you will hear plenty more about this FIH in many lectures of this seminar. More on Minsky's two prices especially in the lectures by Jan Kregel, John Henry, Randy Wray, Eric Tymoigne, Steve Fazzari and others in the days ahead.
- He was also concerned with employment and encouraged many Institute affiliated scholars to further develop, model and explore various modalities of financing, including Abba Lerner's functional finance, his "Employer of Last Resort" policy initially proposed in 1965 and refined in his last book. More on this policy and its application to contemporary situations in the lectures by my colleagues Jan Kregel, (later today) Rania Antonopoulos and Pavlina Tcherneva tomorrow, and Randy Wray and Matt Forstater on Monday and Tuesday.
- He instilled the interest in his former Washington University colleague, John Caskey to study and analyze ***fringe banking***. Caskey's analysis led Minsky and other Levy Institute scholars to develop a proposal to create ***a system of community development banks*** to increase the range of financial services to underserved communities and he pushed President Clinton to adopt it. ***The***

Community Development Financial Institution Act of 1994, even though did not go as far as Minsky's design, is still the result of his ideas.

- In the midst of many financial reform proposals, he supported the research of our colleague Ronnie Phillips to create a system of narrow banks offering deposits while holding only the safest of assets, i.e., US Treasuries.

WYNNE GODLEY JOINS MINSKY

- In an article Minsky wrote in 1963, he explored the importance of the ***macroeconomic identity*** in that given a private sector surplus and a current account deficit, a government deficit would follow from accounting necessity. If the government sector retrenched, altering the fiscal policy stance toward surplus as president Clinton advocated, aggregate demand would fall unless the private sector stepped in to alter its stance by borrowing and at current times as we have observed the unprecedented frenzy of borrowing.

MACROECONOMIC ACCOUNTING IDENTITY(SLIDE)

- When Wynne Godley was about to retire from Cambridge, Minsky was instrumental in bringing him to the Institute. Godley joined the Institute's research staff as distinguished scholar in 1994. Using the three balances as the operating principle, Godley together with Gennaro Zezza developed the Institute's U.S. stock-flow consistent macroeconometric model tracking and running conditional projections of the three balances based on a number of assumptions relating to stocks and flows of private and government sector variables, inflation and growth rates of trading partners. Both Gennaro Zezza and Marc Lavoie will explore the structure of these sorts of modeling exercises and the implications of macroeconomic policy.
- The recent history of these main sector balances for the United States can be seen in the slide shown.

MAIN SECTOR BALANCES (SLIDE)

- Godley first warned of the sectors developing imbalances both internally and externally and the necessity of appropriate policy action as early as 1997. He was concerned with fiscal policy directed toward surplus and the unsustainable borrowing and accumulated high levels of debt of the private sector especially households, and he foresaw the coming recession.
- Using the same operating principle of the three balances, Godley most emphatically pointed out the serious flaws of the euro project and the rules of the Maastricht Treaty. In an opinion piece written in 1997, he foresaw the events currently taking place. As he put it,
    - ***"..if a government stops having its own currency, it doesn't just give up control over monetary policy as normally understood; its spending powers also become constrained in an entirely new way. If a government does not have its own bank on which it can draw cheques freely, its expenditure can be financed only by borrowing in the open market in competition with businesses, and this may prove excessively expensive or even impossible, particularly under conditions of extreme***

emergency." This is precisely what is happening in Greece. And ended by,

- ***"…if Europe is not to have a full-scale budget of its own under the new arrangements it will still have, by default, a fiscal stance of its own made up of the individual budgets of component states. The danger, then, is that the budgetary restraint to which governments are individually committed will impart a disinflationary bias that locks Europe as a whole into a depression it is powerless to lift."***

Drawing on Minsky's and Godley's depth of analysis, the Levy Institute continues to extend their theoretical contributions for a better understanding of the operation and complexity of the modern capitalist economy.