Introductory Remarks

28th Annual Hyman Minsky Conference

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I want to welcome you to the Levy Economics Institute's 28th Annual Hyman Minsky conference. This year marks the 100th anniversary of Hyman Minsky's birth.

Before I go on, let me first express my deepest thanks to my long time friend and closest colleague Jan Kregel, the Institute's Director of Research for the organization of the conference, and to the staff of the Institute for the efficient handling of all logistical details.

Minsky's first conference back in 1991, focused on the issues the U.S. faced at the time, the S&L crisis, the explosion of consumer and other private debt, the aftermath of a housing bubble, and, the economy in recession. Today, we are again confronted with still unresolved and new issues that endanger economic and financial stability. Among them, is the too big to fail issue; the dramatic shift of lending to real estate finance and the consequent real estate risk, as the dominant balance sheet item of the entire banking sector that has contributed to the declining trend of commercial and industrial loans and prompting some commentators to call the commercial bank a misnomer and renaming it the real estate bank.[1]

There is still no definitive regulatory structure to oversee the ever-increasing lending activities of fintechs. Fintech firms provide an easier and faster on-line process for lending, levering on their payment processing services and accounting software to consumers and small businesses. The percentage of personal loans originating from fintech companies has grown larger than that of banks. TransUnion found that fintech

[1] Alex Pollock. 2016. "'Commercial' Bank is a Misnomer. 'Real Estate' Bank is more Apt." *American Banker*, August 8

firms have overtaken banks originating 38 percent to banks 28 percent,[2] helping boost the US personal loan surge to a record $138 billion.

Last but not least, there is the issue of privacy with respect to the new payment systems. A recent article in the Federal Reserve Bank of St. Louis *Review* considers the privacy issue extensively, distinguishing the type and degree of privacy needed as currently provided by cash versus e-cash. Central banks with note issuance responsibilities became privacy providers, but as they are shrinking their paper money business toward other forms of payment, they will need to become privacy regulators instead, paying attention to the public's different needs for privacy.[3]

Turning to the real economy, we take note of the pessimistic projections about the fortunes of the world economy that began rising in 2018. The IMF, in its latest report earlier this month, downgraded again its forecast for global growth to 3.3 percent from 3.5 percent in January and 3.75 percent last October. Recent data, more so in manufacturing than in services, reveal the weakening economic growth in the US and Europe, the decline in bond yields, the trade wars between America, China, and Europe, and the political and economic uncertainties of Brexit all contributing to global instability. Moreover, Hungary's Orban and other Eurosceptic leaders' refusal to accept their refugee quotas, together with France and Italy's disregard of the Eurozone's budget rules—while borrowing at 2 percent due to their membership in it—are challenging the EU's legal power.

In the words of *Financial Times'* Simon Kuper, "Brussels is like a weak schoolteacher who is losing control over the class."[4] Most analysts predict that the next five years in Europe will be the messy process of muddling through the past five years, and that Europe is capable of maintaining such a stance for a sustained period of time. The only positive signs have been coming from the buoyant equity markets, but for how long.

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[2] TransUnion. 2017. "Fact versus Fiction: Fintech Lenders."
[3] Charles M. Kahn. 2018. "Payment Systems and Privacy." Federal Reserve Bank of St. Louis *Review*, Fourth Quarter: 337–43.
[4] Simon Kuper. 2019. "The EU's enemy within: Eurosceptic Remainers." *FT Magazine*, March 23–24: 5.

With all these as background, this year's conference theme is to explore the vulnerability of the US economy, evidenced by the worrisome signs of a global slowdown, in a period of relatively relaxed monetary policy, fiscal policy conservatism, continuing maldistribution of income and wealth, and ongoing financial structure challenges.

Minsky concentrated on the impact of the spillover effects of financial instability on the performance of the real economy given the prevailing regimes of monetary and fiscal policy. He was advocating big roles for both government (fiscal policy) and the central bank (monetary policy), which together with an efficient financial structure would ensure the economy's capital development, economic growth, and employment.

He worried about the tendency of policymakers and economists to choose policies that were relying on market self-regulation rather than a state interventionist structure. In many of his writings about the endogenous generation of financial instability, he made use of Keynes's view of the dangers of speculation. As a Keynesian, Minsky's policy proposals and advocacy derived from his own interpretation of Keynes. His views diverged from the well-known "Keynesian" mainstream prescriptions concentrating on "fine-tuning" of aggregate demand, promoting investment, and instituting "welfare-statism" for the provision of a safety net. He wanted to offer an alternative strategy for the modern, financial, capitalist economy and, in so doing, he emphasized that fine-tuning was impossible; he relied more on stabilizing consumption and employment, rather than investment, and the use of appropriate institutions together with a regulatory structure that constrained financial excesses and economic instability.

Observing the evolving financial structure, Minsky was concerned with the transformation of the traditional banking system into a highly levered financial system that was fragile and constituted of mainly nonbanking institutions, including mutual funds, pension funds, and other shadow banking funds. These funds need to be managed, and their managers presumably operate in the interest of the owners or beneficial owners, but also have their own interests. To earn high fees, they become hungry for higher returns and with more and more excess liquidity available for placement, they outgrow traditional high-quality stocks and bonds portfolios. As we have seen and as Minsky predicted, managers of these funds became buyers of specialized instruments and highly leveraged securities.

The results of the explosion of such instruments together with the gradual adoption of the infallibility of markets, by the central banks and private banking institutions, created a self-regulated financial system which culminated in the global financial crisis of 2008 and the Great Recession. "The aftermath," of which as John Cassidy of *The New Yorker* recently wrote, "produced a lost decade for European economies and helped lead to the rise of anti-establishment political movements here and abroad."[5]

The financial meltdown of ten years ago forced the US Congress to reform Wall Street with new rules and regulations for financial institutions and enhanced responsibilities to the Federal Reserve through the passage of the Dodd–Frank Wall Street Reform Act. Similarly, financial reforms have taken place in Europe and elsewhere, but there is still a lot more work needed with respect to global integration and regulatory harmonization, and the required policy coordination that will reverse the trend toward fragmentation.

The implementation of some regulatory changes notwithstanding, many other important reform issues—such as dealing with unregulated money manager funds, systemic and idiosyncratic risks of financial derivatives, and the "too big to fail" conditions of banks—remain almost as they were before the 2008 financial crisis.

The fear is that the current Washington administration may undo many of the Dodd–Frank regulatory enactments. Some voices from Washington policymakers are encouraging, calling for the break-up of the largest US lenders that are still "too big," together with other regulatory changes. There are, however, stronger dissenting voices from the captains of the banking industry, arguing that our financial services system is complex and dependent on diverse business models coexisting to effectively serve

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[5] John Cassidy. 2018. "The Real Cost of the 2008 Financial Crisis." *The New Yorker*, September 19.

America's vast array of customers, and that large money center banks offer critical services that small banks are unable to provide.

Banks carry an urge to evolve in a way that maximizes revenue and, in so doing often underprice the risk to achieve it—as the cases of JPMorgan's London Whale and Deutsche Banks's risky positions have shown. Banks, in concert with markets, quickly create newer, riskier, and more profitable products. It is the very nature of modern finance to transform its structure in response to prevailing regulation. Banks' continuing risky practices fuel instability in our economic system and will ultimately lead us to another financial crisis. The regulatory structure, Minsky advocated, must be constantly evolving and always subject to sophisticated reexamination as the world of finance develops.

The key role of banking is financing the economy's capital development and this should also be the concern of the central bank. Minsky had proposed that a place to start in enhancing financial stability and the integrity of the markets, would be to reconstitute the financial structure by forcing banks to perform their traditional role and for regulators to begin by breaking them down into smaller units performing their designated functions; a bank holding company structure with numerous types of subsidiaries, each one subject to strict limitations on the type of permitted activities, in Minsky's view, would be a valuable deterrent to risky behavior.

We need banks that can earn competitive rates of return, banks that focus not on big risks, but on financing the economy's capital development. We need, therefore, reforms that limit profiting without producing, but instead promote enterprise and industry over speculation. They will have to be as innovative, flexible, and opportunistic as the markets they aim to improve.

Private sector investment is crucial, but government policy has little influence in stabilizing it. Even in a period of low interest rates, the ability to stimulate growth through investment has proven to be very limited. Easy monetary policy is usually met with cheers from the financial markets, but even markets, at times, appear uneasy with a low interest rate policy. Economists and commentators talk about the dwindling firepower of central banks and that the low interest rate policy may be even more dangerous. Government policy that targets full employment and stabilizes consumption, the main driver of growth, was long advocated by Minsky. He argued that a direct, federally funded employment guarantee program—one providing a job opportunity to any individual willing and able to work—would act as an automatic economic stabilizer, enabling households to meet their financial commitments and substantially reduce the impact of financial shocks.

At the Levy Institute, our plans are to continue focusing on strategic issues of economic policy aiming at achieving financial stability, long-term higher economic growth and employment, the amelioration of the severe income and wealth inequality, and the increase of public spending to narrow the growing infrastructure deficit. This year's conference will explore some of these issues and the linkages mentioned.

We invite you to take a look or take with you some of our publications, and would very much welcome your comments.

Enjoy the conference. We hope you will find the presentations and discussions thoughtful.

Thank you very much for your attention.