

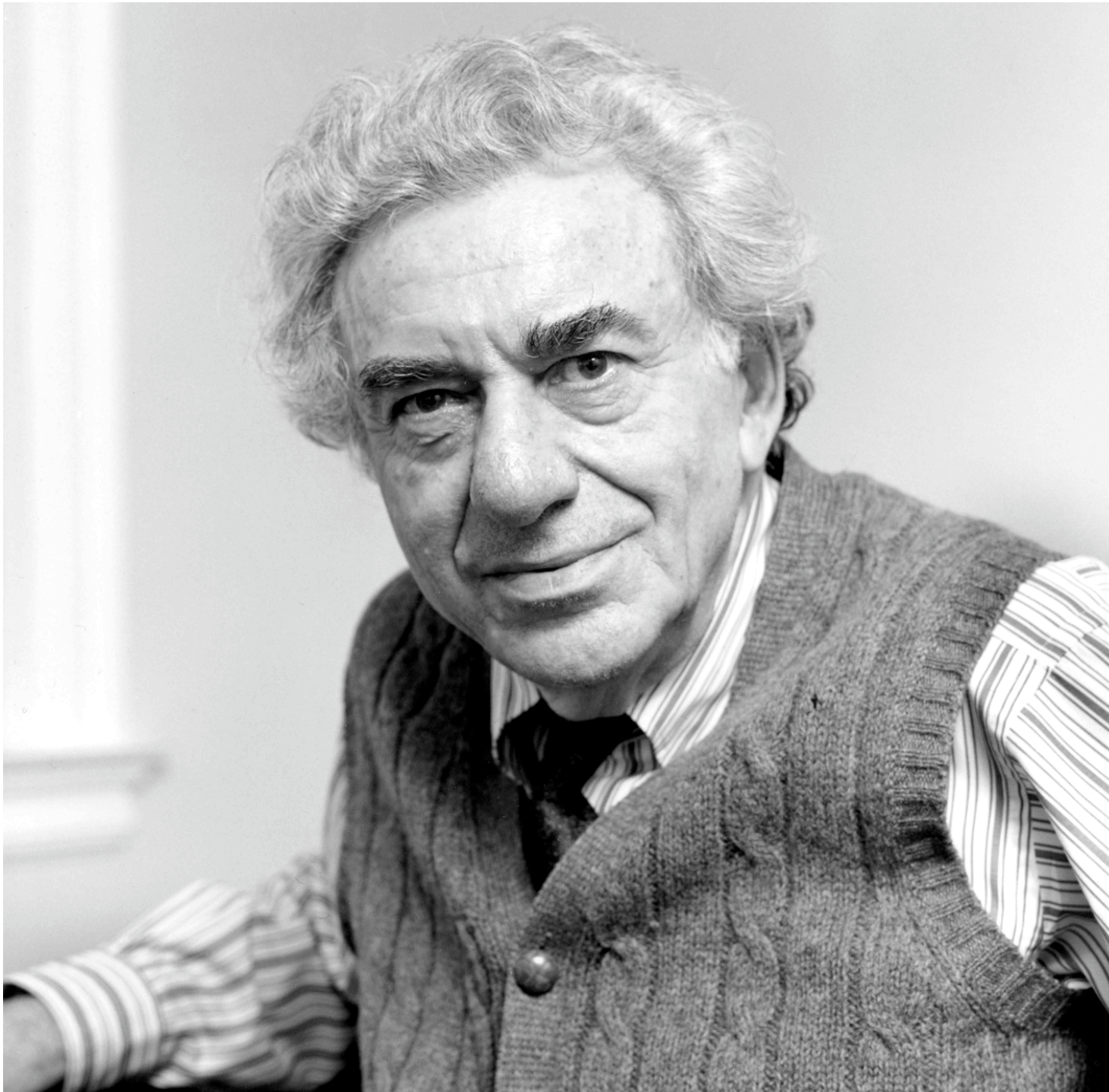


MINSKY AND THE LEVY INSTITUTE

Dimitri B. Papadimitriou

The Hyman P. Minsky Summer Seminar

June 19-26, 2010



Levy Economics Institute



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

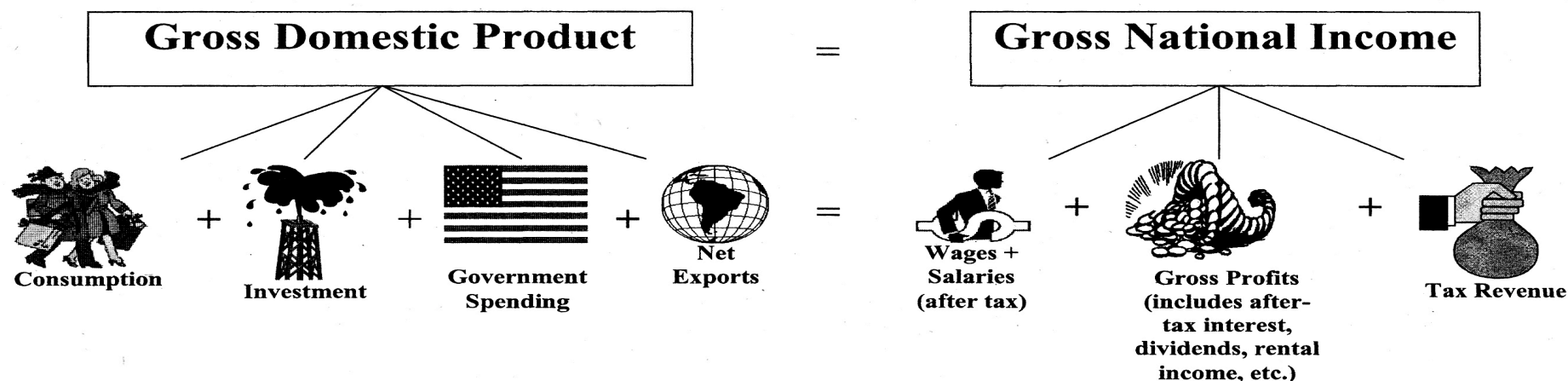


Jerome Levy (who was he?)

- **Studied physics not economics, as a businessman, he was interested in profits**
- **ECONOMICS IS AN EXACT SCIENCE (1943)**
- **Developed the Levy profit equation**

DERIVING THE PROFITS EQUATION

We begin with the simplest national identity:



After some manipulation, we obtain:

$$\text{Gross Profits} = \text{Investment} + \left[\text{Government Spending} - \text{Tax Revenue} \right] + \text{Net Exports} + \left[\text{Consumption} - \text{Wages} \right]$$

Which can be reduced to the fundamental profits equation:

$$\text{Gross Profits} = \text{Investment} + \text{Government Deficit (+) or Surplus (-)} + \text{Net Exports} - \text{Saving*}$$

* More technically, this term is saving out of wages less consumption out of profit income.



"WHAT DRIVES THE LEVY INSTITUTE'S MISSION?"

The Levy Economics Institute is concerned with unemployment, the purchasing power of workers, distribution of income and wealth, gender equality and especially the functioning of financial institutions that ensure prosperity in the real economy.



Minsky and the Levy Institute

- **Minsky joined the Institute in 1986 as advisor and distinguished scholar until his death in 1996.**
- **Importance of Minsky's WALL STREET PARADIGM and FINANCIAL KEYNESIANISM.**

MINSKYAN BIOGRAPHICAL MUSINGS

Who was Minsky and what do we know about him?



- **Born in Chicago (1919).**
- **Attended schools in Lima, Ohio; Chicago and New York City.**
- **Enrolled at the University of Chicago (1937) to study mathematics.**
- **Influenced by the teachings of Oskar Lange, Paul Douglas, Maynard Krueger, Jacob Viner, Frank Knight and Henry Simons.**
- **Long lasting friendship with Gerhard Meyer and Abba Lerner.**

MINSKYAN BIOGRAPHICAL MUSINGS

(cont.)



- **Encouraged by Lange, after graduating, to join the Leontief group at Harvard to help develop the input-output scheme.**
- **At Harvard he met Jim Tobin, Bob Solow, Evsey Domar and Andreas Papandreou.**
- **Began graduate studies at Harvard, but inducted into the U.S. Army.**
- **First stationed in New York and then moved to Europe: England, France, Germany.**
- **While in England met Joan Robinson, Richard Kahn and Piero Sraffa.**

MINSKYAN BIOGRAPHICAL MUSINGS

(cont.)



- **Assigned to the Manpower Division of the Military Government until 1946.**
- **Upon his return, resumed graduate studies at Harvard.**
- **Joseph Schumpeter became his dissertation adviser.**
- **Minsky accepted his first professional appointment at Brown University (1949) and while there, Joseph Schumpeter died. Leontief became his Ph.D. thesis adviser.**

MINSKYAN BIOGRAPHICAL MUSINGS

(cont.)



- **Completed dissertation “Induced Investment and Business Cycles” (1954).**
- **Tenured at Brown, received and accepted an offer from Andreas Papandreou to join the economics department at Berkeley in 1957 and stayed there until 1965.**
- **Moved to Washington University in St. Louis in 1965 and stayed until his retirement in 1990.**

Financial Instability Hypothesis

- **While at Berkeley, an ongoing Bank of America seminar sharpened his ideas and theories about financial innovation and the importance of the initial financial positions that would determine the future of the economy.**
- **Analyzed aspects of the Great Breakdown (1929-33) and determined the economic conditions that might deflate debt.**
- **Taxonomy of financing profiles:**
 - _ **Hedge**
 - _ **Speculative**
 - _ **Ponzi**

Minsky Major Works



- **John Maynard Keynes 1974 [2008]**
- **Stabilizing an Unstable Economy 1986 [2008]**

KALECKI'S INFLUENCE



- **Minsky recognized the importance of:**

- _ profit flows to investment**

- _ government deficits lead to business profits**

- **Kalecki-Minsky view holds that macroeconomic relations determine aggregate profits and that market power and technical conditions of production determine the distribution of profits.**

VS.

- **Orthodox view argues that both the mass and distribution of profits are determined by the technical conditions of production and market structure.**

MINSKY'S "BIG GOVERNMENT" PRESCRIPTION

"If 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 of investment, then both realized and expected profits will be stabilized."

MINSKY'S "BIG BANK" PRESCRIPTION

"In determining an economy's path, it is critically 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 together with shortfalls of cash to validate debts has far reaching repercussions, ultimately leading to a debt deflation. The Central Bank will attempt to contain or abort debt deflation."

MINSKY AT THE LEVY INSTITUTE



- **Established the research program
“Reconstituting the Financial Structure”**
- **Organized and launched (1991) the annual conference on “Financial Structure and the State of the U.S. Economy” bringing together academics, central bank representatives and other policymakers and individuals from financial institutions.**
- **Directed the Institute’s effort to kill the proposed BALANCED BUDGET AMENDMENT.**
- **Continued to refine his *financial instability hypothesis* and joined a group of Italian academics in an attempt to model the FIH.**

MINSKY AT THE LEVY INSTITUTE

(cont.)



- **Resurrected his 1965 "*Employer of Last Resort*" policy and encourages Levy Institute affiliated scholars to further develop, model and explore various modalities of financing.**
- **With a number of Levy Institute scholars, he developed a proposal to create a system of community development banks to offer and increase financial services to underserved communities.**
- **Supported the research of a Levy Institute scholar to create a system of narrow banks.**



WYNNE GODLEY JOINS MINSKY

In 1963, Minsky understood the importance of the macroeconomic identity of financial balances.

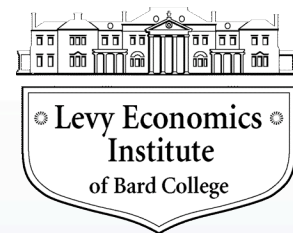
Given a private sector surplus and a current account deficit, a government deficit would follow by accounting necessity. If the government sector retrenched, altering the fiscal policy stance toward surplus, as President Clinton advocated, aggregate demand would fall unless the private sector stepped in to alter its financial balance.

WYNNE GODLEY AT THE LEVY INSTITUTE



- **Joined the Institute in 1994.**
- **Using the operating principle of the three balances, he developed, together with Gennaro Zezza, the Institute's U.S. stock-flow consistent macroeconometric model.**
- **Tracking the paths of the three balances and running conditional projections of these balances based on a number of assumptions enabled him, and others at the Institute, to foresee the implications of various macropolicy proposals.**

The Conceptual Framework



Accounting Identity of Financial Balances



In 2006 the identity was roughly like this:

-3.0% of GDP -2.4% of GDP = -5.4% of GDP

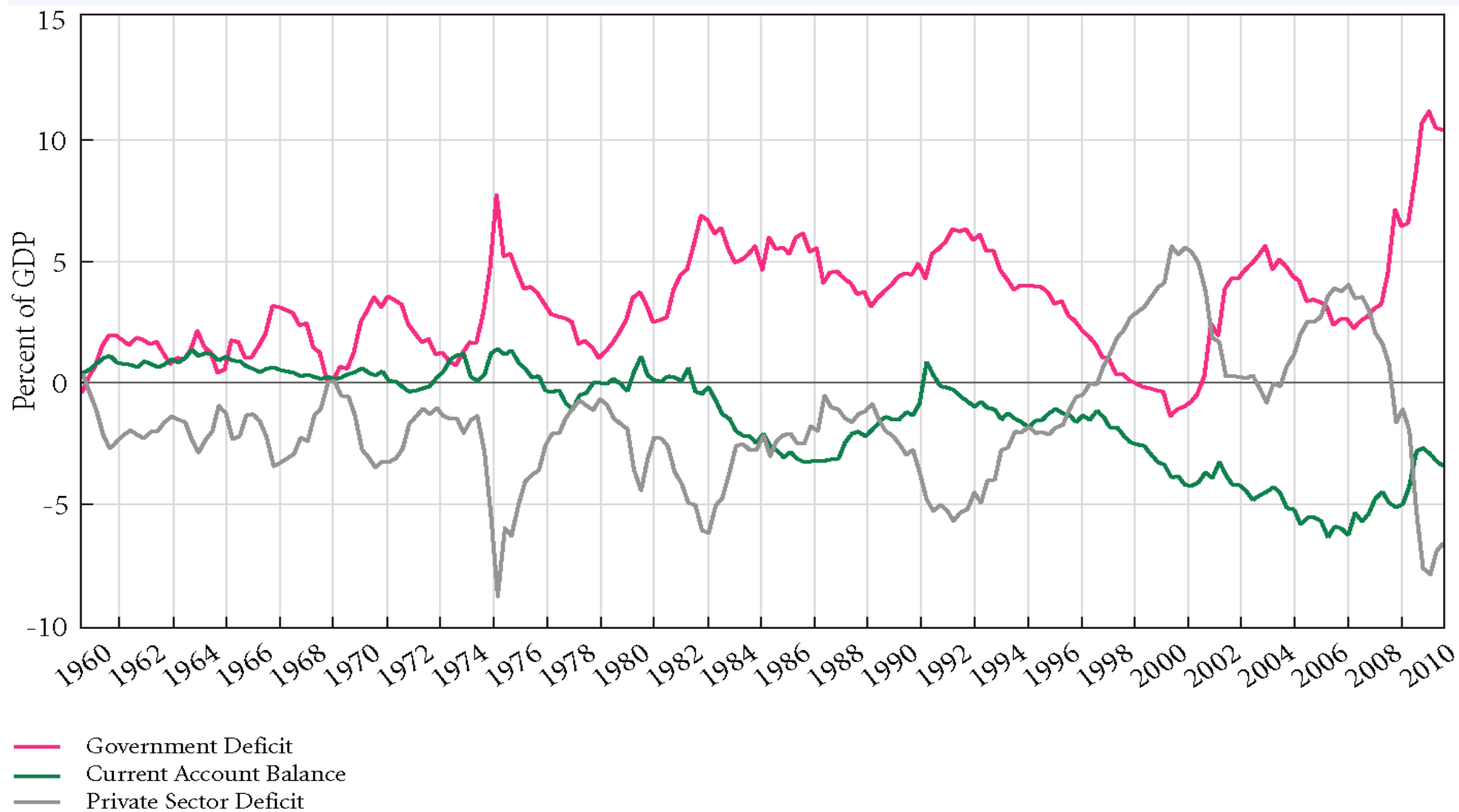
In 2009 the identity was roughly like this:

7.0% of GDP -10.0% of GDP = -3.0% of GDP

In 2010 (1st quarter) the identity was roughly like this:

6.7% of GDP -10.3% of GDP = -3.6% of GDP

MAIN SECTOR BALANCES



Sources: BEA; authors' calculations

GODLEY'S REACTION TO THE EURO PROJECT



Writing in 1997 on the serious flaws of the Euro project, and especially the rules of the Maastricht Treaty, he said:

"...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."



www.levyinstitute.org