MINSKY'S MONEY MANAGER CAPITALISM AND THE GLOBAL FINANCIAL CRISIS

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Global crisis: Lessons from Keynes and Minsky

- Crisis represents
  - an institutional failure (banks mutated from utilities to casinos);
  - an intellectual failure (dangerous view of efficacy of mkts);
  - and moral failure (system built on money values)
- Instinctive and quick return to Keynes (the master—Skidelsky)
- With Minsky's insights on the transformation that led to the crisis

Is the Financial Crisis over?

- No. Hardly begun:
  - Residential real estate, commercial real estate, shopping mall debt, home equity loans, credit card debt, student loans, auto related debt, business loans, Euro debt, developing country debt, state and local government debt, pension funds, insurance companies, credit default swaps, CDOs, CDO-squared, CDO-cubed, SPVs, SIVs, Life insurance settlements, peasant insurance, REITs, junk bonds, interest rate swaps, financialized health care…

- This is round 3 of a 9 round bout:
  - Round 1 = liquidity crisis of shadow banks
  - Round 2 = wave of insolvencies of home mortgage specialists
  - Round 3 = bail-outs and cooking the books to pay bonuses
  - Round 4 = another round of defaults forces loss recognition
  - Round 5 = knock-out punch with a full scale Minsky-Fisher debt deflation dynamic

A Minsky Moment or a Minsky Half-Century?

- Stages Approach
  - Commercial capitalism
  - Finance capitalism
  - Paternalistic (Managerial-Welfare State) capitalism
  - Money Manager capitalism (financialization, ownership society, neoliberalism, neoconservativism, shadow banking)
    - Stability bred instability
    - Accumulation of financial assets/liabilities
    - Globalization
    - Securitization
    - Self-supervision

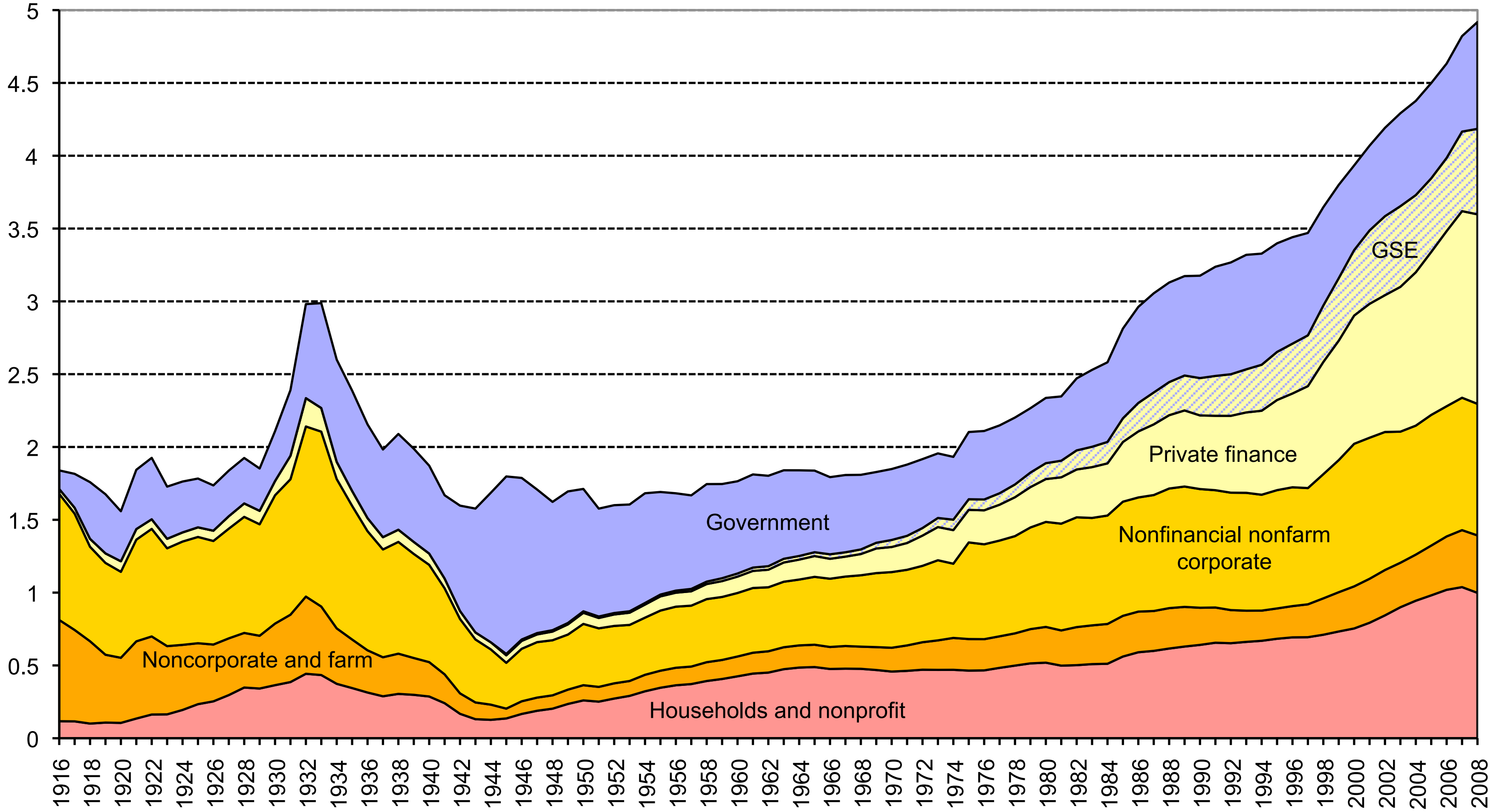
Four Recent Trends

- Rise of Managed Money (decline of banking)
- Investment Banks go Public
- Regulation and supervision replaced by self -supervision
- Transformation of business "environment"

1. Rise of Managed Money

- Two aspects of note:
  - Volumes of assets and liabilities ("financialization"→increases finance's share)
  - Competition with banks ("shadow banking"→innovations, leverage, and deregulation)

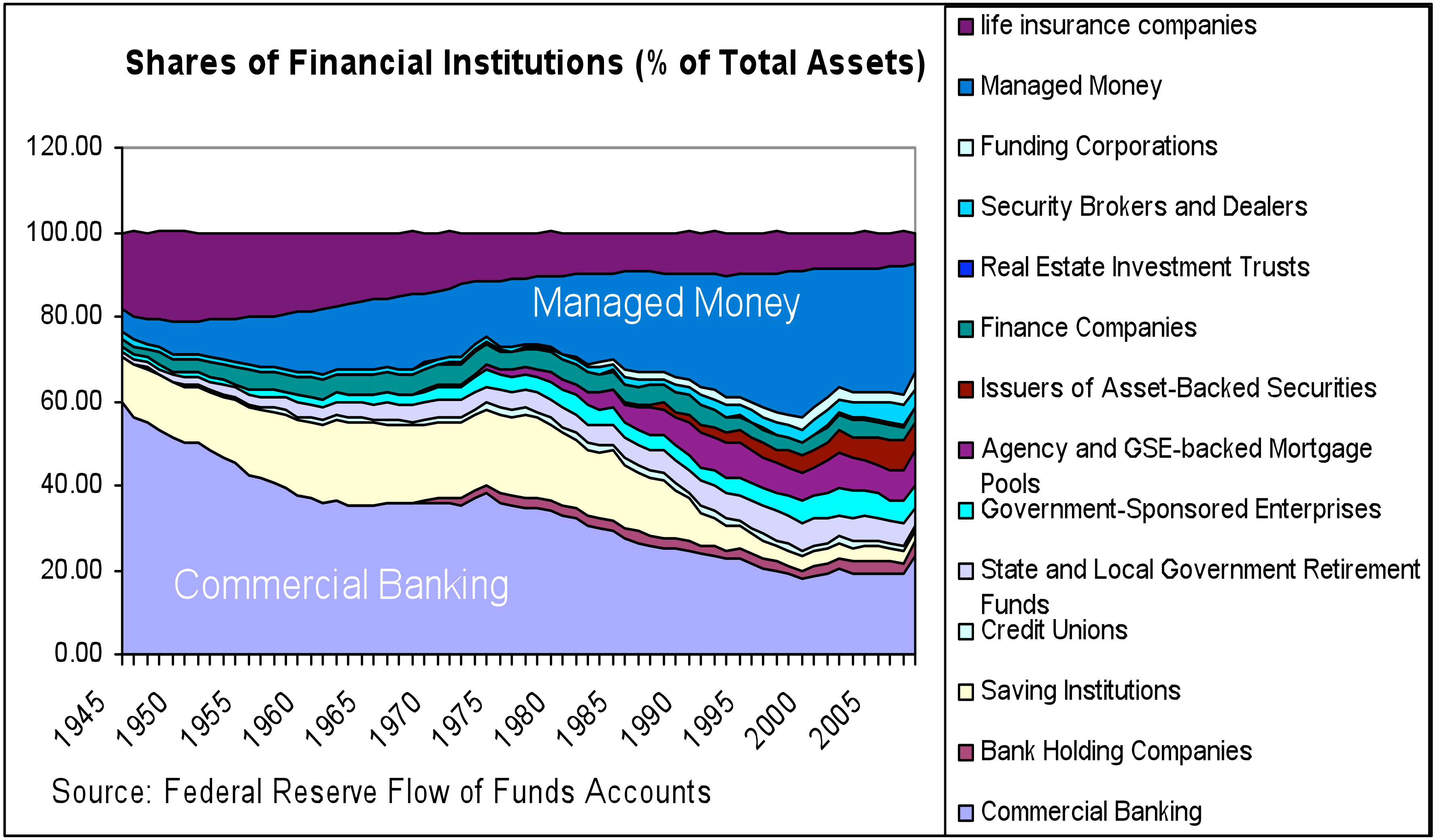
Total Financial Liabilities Relative to GDP

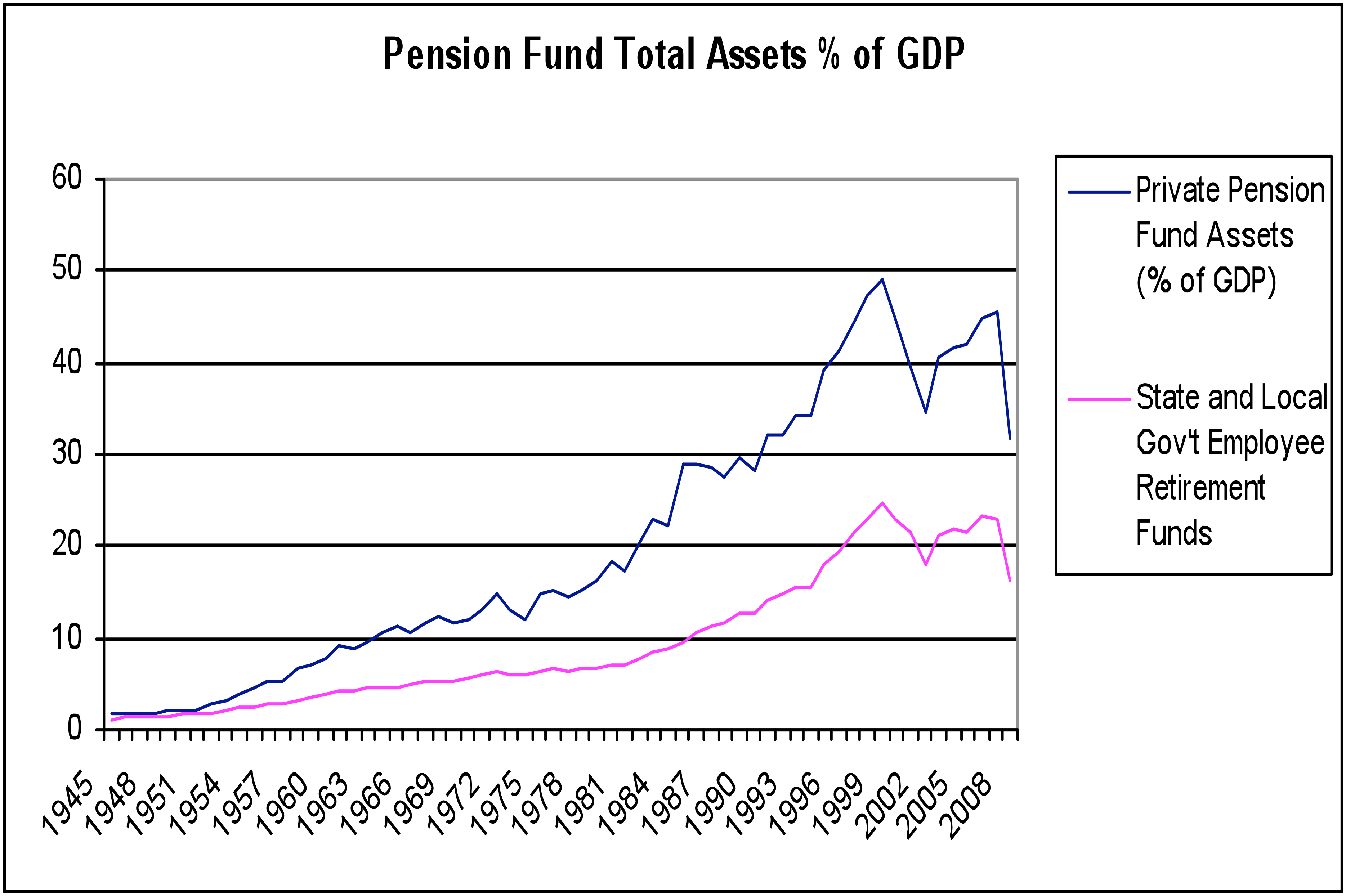


Sources: *Historical Statistics of the United States: Millennium Edition* (Tables Cj870-889, Ca9-19, Ce42-68, Cj787-796, Cj748-750, Cj389-397, Cj437-447, and Cj362-374), *Historical Statistics of the United States: Colonial Times to 1970* (Series X 689-697), NIPA, Flow of Funds (from 1945).

Note: The government sector excludes all financial activities of the government (retirement funds, GNMA, etc.). GSE sector includes government-sponsored enterprises and agency- and GSE-backed mortgage pools (includes, among others, GNMA and FHA pools). "Private finance" excludes the GSE sector and monetary authorities (which are both part of the financial sector in the Flow of Funds accounts). Before 1945, data for financial institutions is computed from data of the Census Bureau by taking all the liabilities (excluding equity) of commercial banks, credit unions, savings institutions, life insurance stock companies, and property and life insurance companies, and by removing private banks notes, all deposits, and life insurance reserves. From 1945, the total financial liabilities of the financial sector excludes, net interbank liabilities of commercial banks, liabilities of monetary authorities, private and public pension fund reserves, money market mutual funds shares, mutual funds shares and the items previously cited. The liabilities of monetary authorities are not included anywhere. Data for the households and noncorporate sectors is deduced from Census Bureau data about net increase in liabilities and by computing backward from the 1945 level.

Decreasing Weight of the Banking Sector



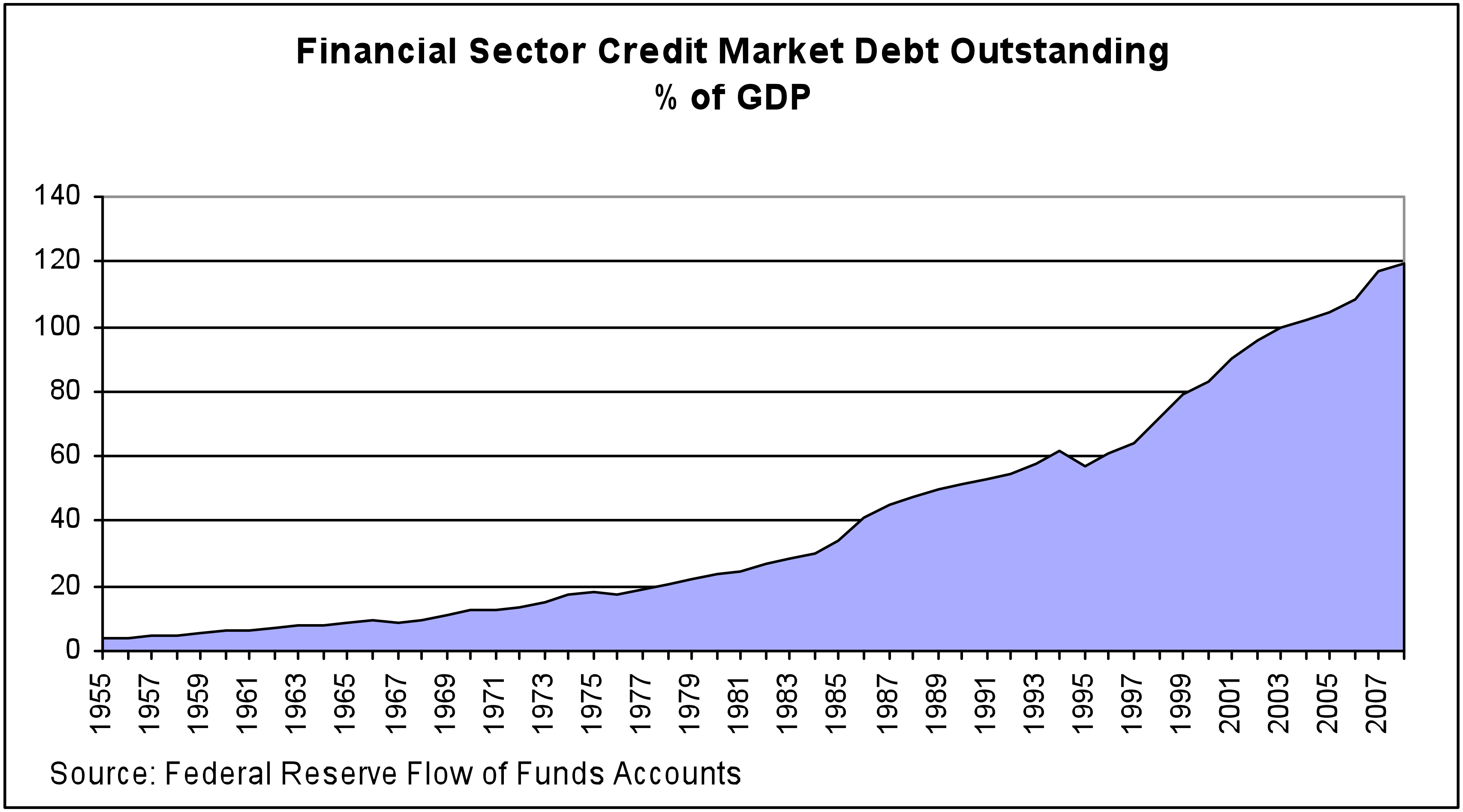


Pension Fund Total Assets % of GDP
0
10
20
30
40
50
60
1945
1948
1951
1954
1957
1960
1963
1966
1969
1972
1975
1978
1981
1984
1987
1990
1993
1996
1999
2002
2005
2008
Private Pension Fund Assets (% of GDP)
State and Local Gov't Employee Retirement Funds

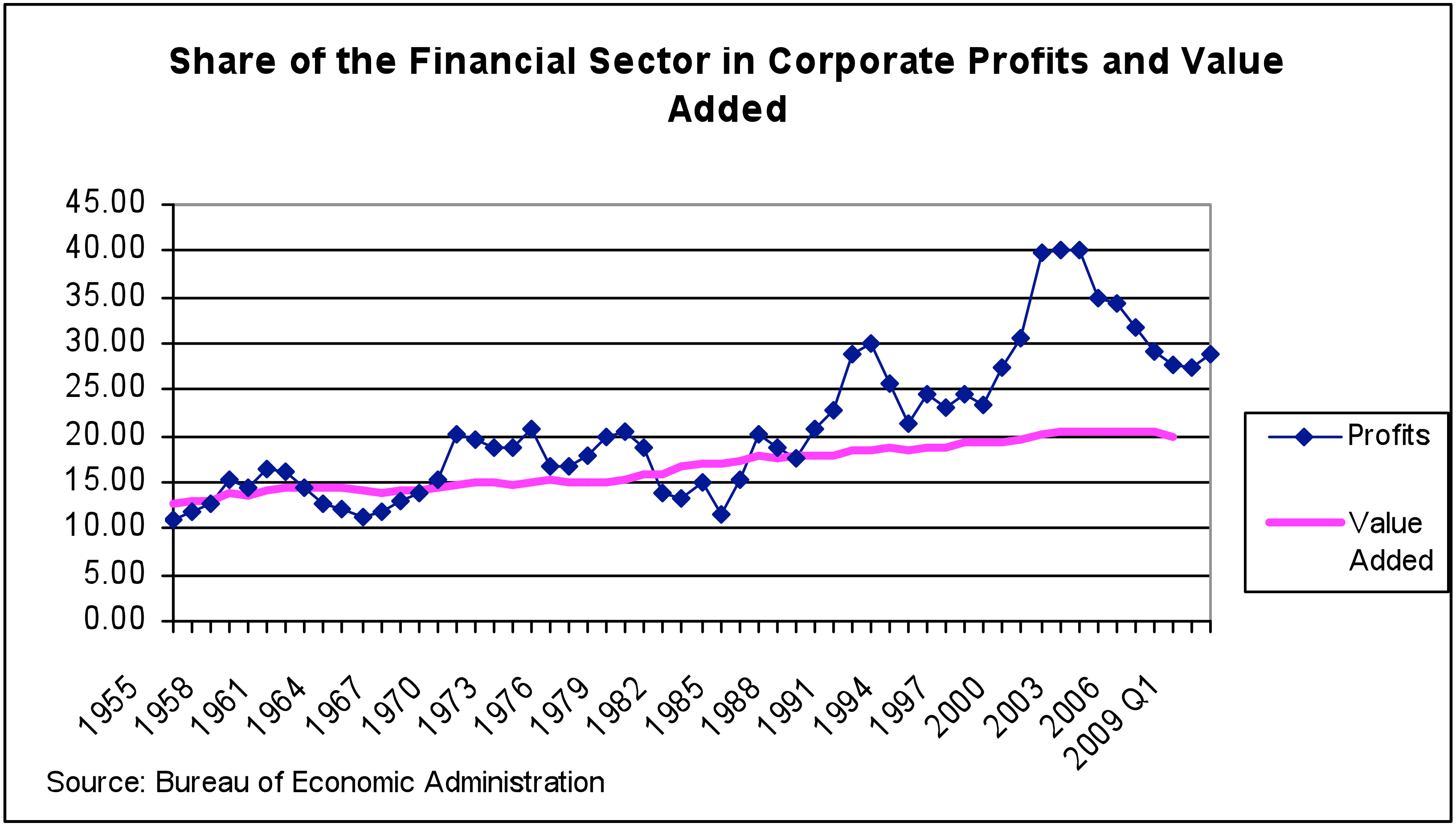
Financialization

- Layering, leveraging
- Prior commitment of future flows
- Cannot be serviced out of income flows: Ponzi
- Requires capital gains: prices must always rise

Financialization of the US Economy



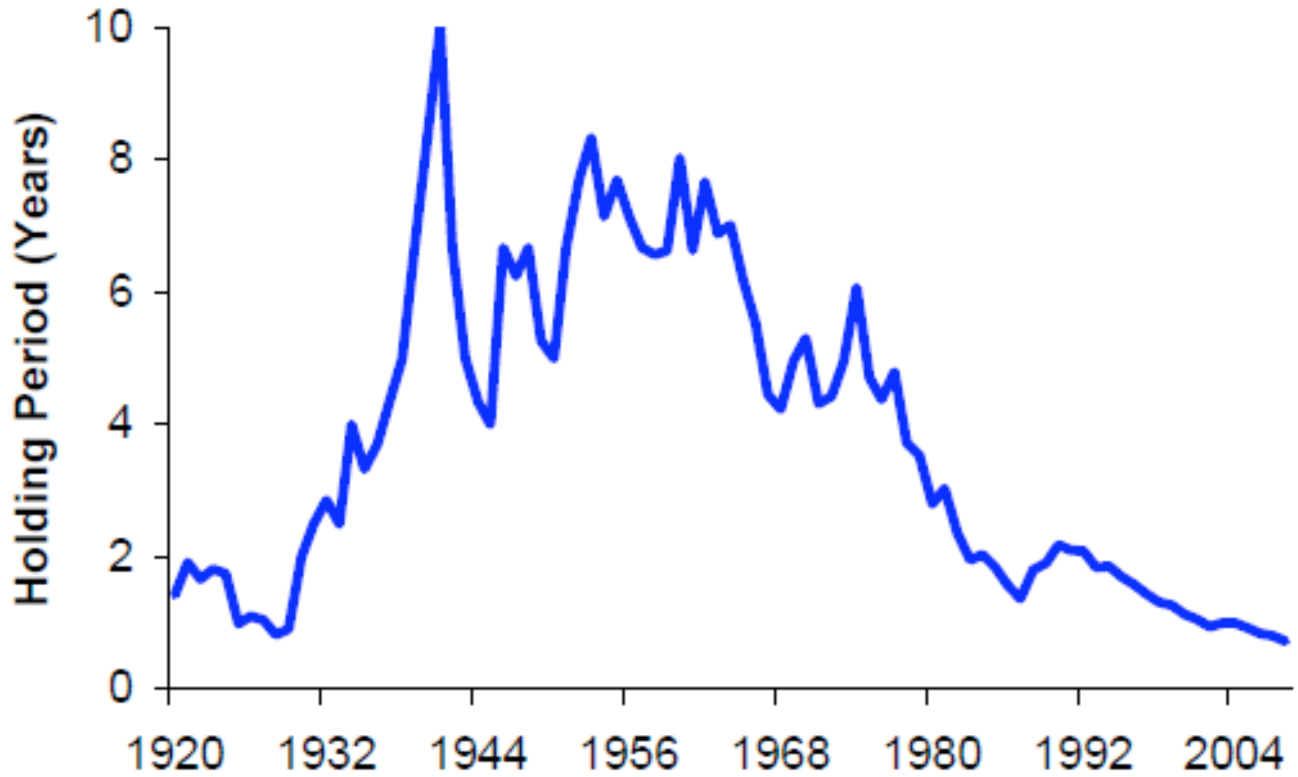
Financialization of the US Economy



2. Investment Banks go Public

- 1929 All over again: Investment Trust Subsidiaries of Wall St partnerships
  - Promoted massive leverage and "pump and dump" speculative fever
- Shift to trading rather than placements
  - Top management incentives to manipulate share prices and trade on inside info
- Research arms, ratings agencies become little more than marketing divisions
  - Trader mentality dominates: Vendibility rather than serviceability

Exhibit 2: Average holding period for a stock on the NYSE (years)



Source: NYSE, GMO

J.M. Keynes

- When speculation comes to dominate enterprise the job is likely to be ill-done

3. Deregulation, Desupervision, Self regulation

- Moving assets and liabilities off balance sheet, increasing leverage
- Riskier assets, mismatched maturities
- Securities and other derivatives; “Modernization” removing constraints on pensions, ending Glass Steagall
- Risk-based capital reqmts, internal models, external ratings agencies
- Transformation completed by handing bank charters to the two remaining investment banks

4. Changing business "environment"

- Lehman's "actionable" and "materially misleading" practices approved by Mngmt and Ernst&Young. Why?
  - No other way to win business
  - No fear of prosecution
- Trader mentality triumphs
- Goldman and Greek debt
- Magnetar, CDOs and CDSs
- Control Fraud as normal business practice
  - S&Ls

Clarification: Fraud is not the cause of the crisis

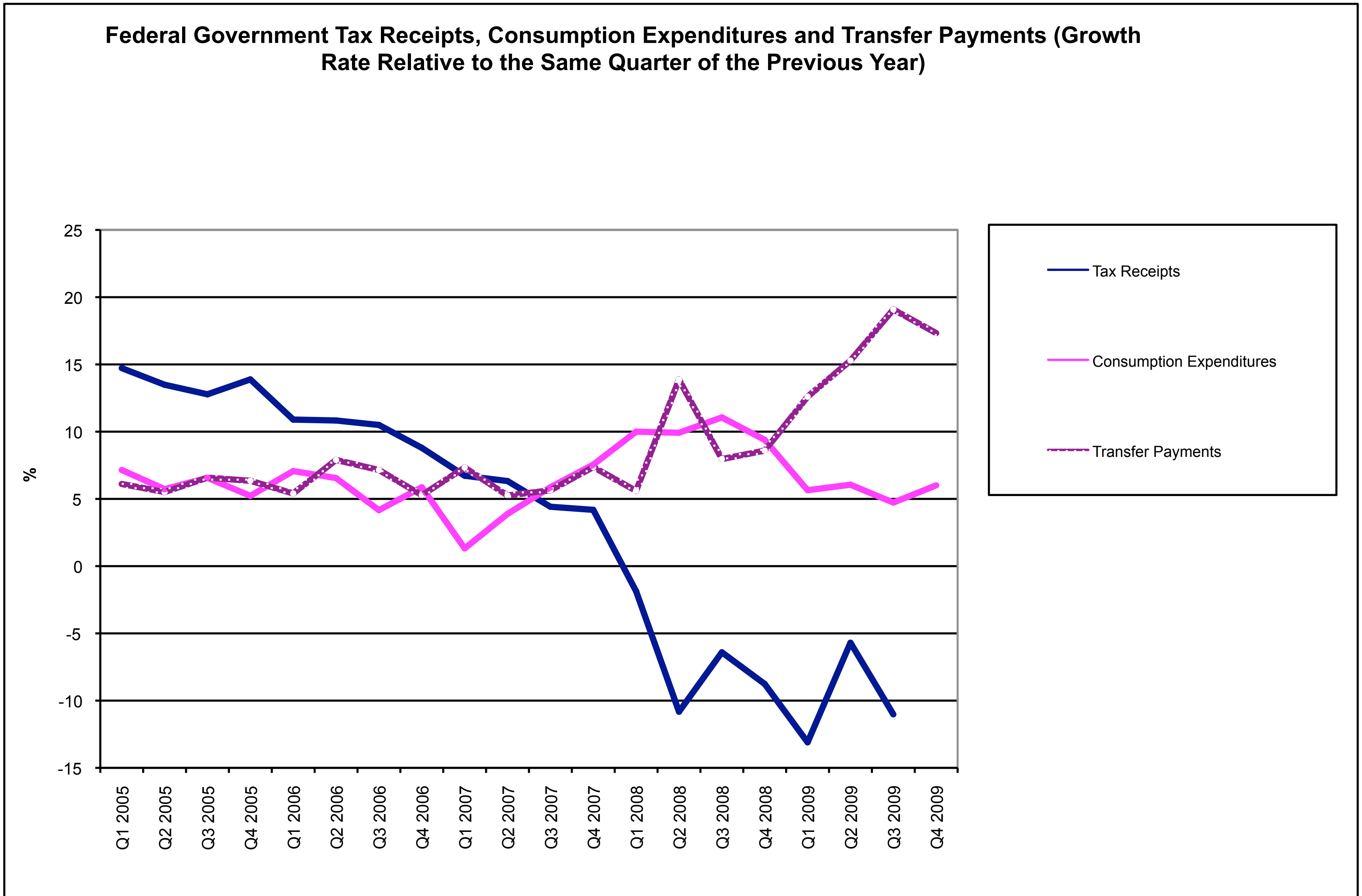
- Long term transformation of financial system
  - Normal innovations plus self regulation, laxity
- Long term growth of managed money
  - Absence of debt deflation; promotion of saving
- Long term stagnation of real wage
  - Democratization of credit
- Chronic fiscal drag, worsened by trade balance
  - Three balances; private sector deficits

Policy Response

- Policy actions are directed at saving the system, not reforming it
- Mergers and acquisitions against rules; Too big to fail institutions even bigger today than they were before the crisis
- No criminal prosecutions of those responsible for the current crisis
- Reliance on Wall Street to reform itself, belief that gov't only needs to get the incentives right for market discipline to work

A Major Obstacle: Deficit Hysteria

- Always 2 ways to create deficits: the Ugly way and the Good Way: China vs US & Japan
- Deficit Fears not applicable to sovereign national debt
- Spends by crediting accts, taxes by debiting
- Deficits = net credits to deposits & reserves, and create income and net financial wealth of nongovt sector



Source: Bureau of Economic Analysis and Authors' Calculations; Tax Receipts Data Unavailable for 2009 Q4

Minsky’s policies to promote stability

- High consumption, high employment
  - Greater equality, rely on income, not debt
- Favor small to medium size banks; CDBs, not predatory lending; debt relief
- Don’t waste a crisis: De-financialize; downsize. Resolve
  - Definancialize healthcare, retirement, education
- Enhanced oversight; strengthened regulation
  - Nothing off-balance sheet
- Institutions and practices to favor stability
  - Automatic stabilizers: countercyclical budget
  - Institutional Circuit breakers
- No “final” solution to fundamental flaw of capitalism