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On Minsky's Agenda for Reform

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In economics, theory and policy are intimately related. Policy recommendations are derived from theory, and in turn theory is revealed by dicta regarding policy. Chapter 13 of Minsky's *Stabilizing an Unstable Economy* is an unusually complete design. Here is Hy Minsky's conception of a stable, prosperous, efficient, equitable capitalist system. It is the final chapter of his 1986 book, and I found it the most revealing exposition of Minsky's theory and his differences from other versions of Keynesian economics. It is an ambitious and comprehensive manifesto.

Minsky's objective is no less than to design a self-regulated system, one that does not depend on frequent discretionary policy moves, whether by central banks, finance ministries, regulators, or legislatures. It is not that Minsky is fashionably advocating rules for policy-makers rather than discretion. It is not that he is trusting an Adam Smith-Gerard Debreu Invisible Hand, although he does see an indispensable role for market competition and proposes a number of institutions to protect and promote it. It is not that he derogates the roles of government, either micro or macro. To the contrary, his self-regulating capitalist economy depends for its stability on Big Government, the source of macroeconomic built-in counter-cyclical variations of aggregate demand and thus of profits.

The federal government, according to Minsky, should account for about 20% of full-employment GDP. Full employment he identifies with 6% unemployment, although he surely and gladly would now revise that downward in the light of recent experience. Anyway, he rejects the current practice of monetary policy, guessing at the "NAIRU" and trying to get there and stay there by variation of money-market interest rates. Instead, he wants the government to be the employer of last resort at a fixed minimal money wage rate — via a combination of New Deal type measures, Works Progress Administration (WPA), Civilian Conservation Corps (CCC), National Youth Administration (NYA). By this device, the built-in stability effects of fiscal policy are enhanced by the variations of applicants for the guaranteed jobs, and the nomimal wage and price level are stabilized. There are a good many practical difficulties in this proposal, but they are probably surmountable. Research on the idea continues right here at this Institute. Whether, as Minsky hoped, this self-regulating mechanism dispenses with the need for monetary and fiscal responses to macroeconomic events, is I think still uncertain.

Minsky thought that Big Government stabilizes because it is comparable in size to Profits, the macro dynamo of capitalism. A more traditional Keynesian would explain built-in stabilizers by aggregate demand multipliers and the investment/saving nexus, but of course profits and aggregate demand move together, and so do saving and investment. So this may be distinction without difference.

Minsky expected and favored balancing the budget when the economy is operating at full employment, with deficits and surpluses reflecting only cyclical aberrations. Relying on his automatic government employment mechanism to stabilize nominal wage and prices — levels, not rates of inflation — Minsky opposed indexation of any government (or private) monetary transactions.

As we know, Minsky regarded capitalist financial markets and institutions as the principal agents of instability, and much of his new architecture is financial reform. Taking the Federal Reserve, or any other central bank, out of the business of macroeconomic stabilization, in accordance with the proposals just discussed, is one step. In Minsky's view, it's a dangerous mistake to try to stabilize the economy by affecting interest rates and asset prices. That itself feeds speculation, in his view. Minsky would have the Fed vary nominal interest rates much less, and for less macroeconomic purposes. Furthermore, his prescription of budget balance across business cycles would tend to hold federal debt constant relative to GDP and stabilize the interest rate term structure.

Yet Minsky foresees important roles for the central bank, some revived from earlier practice, some new. Minsky wants to revive the discount window as the major source of bank reserves, downgrading open market operations in federal debt instruments. (If current predictions of federal surpluses are correct, this may happen anyway in the next 15 to 20 years.) Minsky likes real bills, specific to-the-asset lending, and he thinks it would be healthy for the Fed and the commercial banks to join in this type of finance. It would be a good role for small banks and maybe even for regional Federal Reserve Banks (otherwise redundant).

Minsky would make the Federal Reserve responsible for the entire financial system, not just money markets and depository institutions. The Fed would supplant other state and federal regulatory authorities. All financial enterprises, not just banks, would have access to Federal Reserve loans and advances. Glass-Steagall and other arbitrary divisions of financial turf, most dating from early New Deal laws, would be erased. Tax laws and other regulations would preserve financial firms varying in size, purpose, and location.

In Minsky's view, the corporation has been the source of most of the perils of instability in modern capitalism. The basic reason is the inherent riskiness of long-lasting special purpose physical capital assets. In comparison, wealth-owners want earlier liquidation. Equity markets appear to reconcile these differences, but only by inviting great waves of speculation. Minksy wants to remove the tax incentives for leveraging equity or long-term bond positions — deductibility of corporate interest. Indeed he wants to abolish corporate income taxation and impute undistributed profits to individual share-owners as taxable by personal income tax. He decries any "too big to fail" safety nets, easing the pain by simplifying bankruptcy proceedings. The speculative and Ponzi finance involved in so-called hedge funds (not to be confused with Minsky's approved hedge finance) would doubtless persuade Minsky to advocate stronger measures. He would not shrink from having the Fed regulate adventurous financial enterprises. Recent events, like the debacle of

Long-term Capital Management (LTCM) show how rampant leverage can make it possible for firms of modest net worth to influence asset prices by their own transactions — they are not price takers when they have to unwind outrageous leverage.

Minsky advocated programs to diminish the inequalities of market outcomes among individuals. He greatly preferred programs with good incentive effects, like the employment supports mentioned above. For the same reasons, and others, he disliked means-tested transfers and recommended universal children's allowances, to be included in taxable incomes.

Economists and economic historians will for a long time debate the interpretation of the contrast between the high first 25 postwar years of growth and high-employment, and the succeeding and the disappointing quarter century that followed. Which was normal? Which was abnormal? The anti-Keynesian monetarist new classical view is that the policy errors of the first period led to the disasters of the second. The Keynesian view is that the theories and policies of the first postwar period were sound, that policy errors were made in the Vietnam war period and their consequences were compounded by incredibly adverse exogenous supply shocks in the 1970s — mainly the two big OPEC oil price increases. In this view, in normal circumstances something like the prosperity of 1945-1969 could be obtained, though quantitatively less impressive, without drastic changes of policy. Minksy's viewpoint is different from both of these interpretations. He attributes the reversals of the early postwar prosperity to the inevitable evolution of capitalism, particularly capitalist finance. His Chapter 13 is designed to mitigate the vulnerabilities that produced these reversals. What would he think of the successes in the 1990s of mainstream Keynesian policies in the hands of Greenspan, without the help of much in the way of Minsky reforms? He would not care to extrapolate. He ends his book predicting that capitalists' destructive financial innovations could spoil even a Minsky-designed capitalist system.